In the

Supreme Court of the United States

October Term, 1925.

No. 295.

HENRY P. KEITH, late Collector of United States Internal Revenue for the First Collection District of New York,

Petitioner,

v.

EMMA B. JOHNSON, as administratrix of the goods, chattels, and credits which were of John G. Johnson, deceased,

Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR RESPONDENT.

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INDEX.

LIST OF CASES CITED AND WHERE

STATUTES INDIRECTLY INVOLVED.

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Opinions in the Courts Below.

The opinion of the United States District Court for the Eastern District of New York, is reported in 294 Fed. 964, and is found in the Record at pages 10 to 14.

The opinion of the United States Circuit Court of Appeals for the Second Circuit is reported in 3 F. (2nd) 361, and is found in the printed Record at pages 17 to 20.

The "Grounds of Jurisdiction",
The "Statement", the "Facts" and
The "Statutes Involved" are as

printed in Petitioner's brief.

Summary of the Argument.

That the payment of the New York Inheritance tax by the Administratrix being a lump payment of $233,-044.20 was the ordinary payment of taxes imposed upon the Estate which the administratrix was compelled by statute to pay.

That the New York Inheritance tax is imposed upon the estate as is the Federal Tax. That the fact that the method of calculating it varies according to the degree of relationship of the beneficiaries to the decedent and amounts involved cuts no figure.

That the New York tax is paid by the personal representative of the decedent out of the mass of the property before distribution as other taxes are paid.

The Petitioner relies on a false theory in this: it contends that because the State Inheritance tax cannot be deducted from the capitalization of an Estate for the Federal inheritance tax—that therefore it cannot be deducted by an *Income Tax* payer from his gross income.

The Respondent says that's quite another thing!

ARGUMENT.

POINT I.

The New York Transfer Tax was a tax paid by the estate within the meaning of Section 5 (a) of the Revenue Act of 1916.

Since the Woodward case the Government some time ago admitted and now admits in its brief that the New York Transfer Tax is deductible either by the estate or beneficiary though it indicates the latter.

Consider what has been doing as to their belated contention that in New York only the beneficiary can recover back. They have while this claim has been kept off from final judgment in this Court, not won a single case on the point.

Including four decisions of the new board of Tax Appeals there are now seven new decisions that the Estate can recover.

Those new decisions are:

> *Johnson* vs. *Keith,* 295 Fed. 964 (D. C. E. D. N. Y.);
>
> *Keith* vs. *Johnson,* 3 Fed. (2nd) 361 (C. C. A. 2nd Cir.).
>
> *Farmers Loan & Trust Co.* vs. *United States* (Corporation Trust Co. Income Tax service, p. 1082) (D. C. S. D. N. Y.);
>
> *Appeal of Farmers Loan & Trust Co.* (3 Commerce Clearing House, U. S. Board of Tax Appeals Reports, p. 3578);
>
> *Appeal of Munson* (3 Commerce Clearing House U. S. Board of Tax Appeals Reports, p. 3643);

Appeal of Young (3 Commerce Clearing House U. S. Board of Tax Appeals Reports, p. 3650);

Appeal of Lovett (3 Commerce Clearing House U. S. Board of Tax Appeals Reports, p. 3654).

The opinions in the five last mentioned cases are printed in full in Appendix B.

The Opinions of the Courts below are so carefully considered and well reasoned that this case really needs no other brief. The question in issue as those Courts pointed out is ruled by three adjudications. The Woodward case in this Court as to general recovery. The Prentiss case in the 2nd Circuit reinforced by the former Court to the effect that the beneficiary cannot recover and the Home Trust Case of the New York Court of Appeals that the Estate can recover.

In these days of voluminous briefs it seems necessary to meet long trumpeting with the same sounding instruments so the earlier cases will be modestly sounded.

But the question is a very narrow one, and the answer very simple. The question is whether the New York transfer tax is imposed upon the beneficiaries. If it is, the Government's contention is sound. If not, the Government's contention is wrong. There is no case which even suggests that the New York transfer tax is imposed on the beneficiaries. Undoubtedly it might have been. The Legislature might have said that when a person dies, those to whom the property passes shall be required to pay a tax measured upon the amount of the property which each of them has received and his relationship to the decedent. The constitutionality of such a tax would be sustainable upon exactly the same basis as any transfer or inheritance tax. If the Legislature had done this, it would have been necessary for

the taxing authorities to collect the tax from each of the beneficiaries by a personal action, or to collect it out of the property which might not be easily locatable. The Legislature knew that estates are administered under the supervision of the court, and that for a considerable period of time, generally a year, the executor or administrator has in his possession all of the personal property which belonged to the decedent. Obviously, it would be much simpler to collect a tax imposed upon the estate in the hands of the executor and payable by the executor out of that property. And this is just what the Legislature did. It provided that the tax should be a lien upon the property. It required that the executor should pay the tax before obtaining his discharge in the Surrogate's Court. It directed the executor to pay the tax out of the money to which the beneficiary would have been entitled but for the existence of the tax, or, if the beneficiary was entitled to property, to sell a sufficient amount of the property to pay the tax. The liability of the beneficiary is both in theory and practice, purely subordinate. How can it seriously be suggested that under such a statute the tax is imposed upon the beneficiary, when that is the very thing that the Legislature elected not to do?

The original Rules and Regulations of the Treasury Department—Income Tax Bureau were as follows, before the Woodward case decision.

Article 134, Regulation 45.

"Since the tax (New York Transfer Tax) is imposed upon the transfer before the property reaches the legatees or distributee, it merely diminishes the capital share of the estate received by him, such tax is not imposed upon the legatee or distributee *and is not an allowable* deduction from his income."

The early cases run on the ideas, viz., which stated generally are: that the Tax is a "transfer" tax and that

the beneficiaries do not pay it,—that the decedent's estate pays it.

The New York Courts have held in a long line of unbroken decisions that its transfer tax is not laid upon legatees or payable by the legatees. An early case was the matter of *Swift, 137 New York, 77.* This case was cited with approval in *Prentiss* v. *Eisner* in the Federal Courts and has been cited with approval in practically every important court of appeals case dealing with the question of the transfer tax.

In the matter of *Merriam 141—N. Y., 479*—the court citing with approval its decision in the matter of Swift holds that "The transfer tax is payable even though the legatee was the United States." If this were a tax payable by the legatee, no tax payment would have been required, since the United States would be exempt.

In the Matter of Penfold, 216 N. Y., 168, a question arose as to whether the New York transfer tax should be computed upon the market value of the securities when left by the decedent or upon their value when received by the legatees. Were the tax payable by the legatee, the computation should clearly be on the value of the property received by him. Yet the court held that the market value of the securities at the time decedent dies, governs.

The Legatee Cuts no Figure. He Gets Nothing Until After the Tax is Paid With Estate Money.

The following authorities in the courts of the United States and New York State expressly hold that in the language of the Perkins case now cited and following it that: "The tax is not upon the property, in the ordinary sense of the term, but upon the right to dispose of it, and it is not until it has yielded its contribution to the state that it becomes the property of the legatee."

We now come to the case of:

United States vs. *Perkins,* 163 U. S., 625 (1896).

This case has given the Petitioner's Counsel much anxiety. He strives on four pages to get around it. It is yet a leading case. While old it has been cited and relied on in substantially all the subsequent cases. It is referred to in the last decision, viz., in this instant case (side opinion in Record Judge Learned Hand, foot p. 19).

The case arose as to a bequest to the United States, and involved the question of the power of New York States to tax the bequest. It surveyed the powers of the State as to Inheritance Taxes on high general principles. The lapse of time and change of details in statutes have not affected the broad lines laid down in it. The opinion, (Brown, *J.*), contains this statement quoted time after time thereafter:

> "Thus the tax is not upon the property in the ordinary sense of the term, but upon the right to dispose of it; and it is not until it has yielded its contribution to the State that it becomes the property of the legatee" (p. 628).

Matter of Merriam Estate, 141 N. Y., 479 and 484.

This is the original of the Perkins case, being the litigation begun in New York. And all that has been said of the case under Perkins' name applies here. It is on a line with the Swift case, its predecessor and which it followed.

The two Prentiss cases are referred to here in their order though treated elsewhere.

People ex rel Prentiss vs. *Eisner* (*Collector*), 260 Fed. 589, A. N. Hand (D. J.), S. D. N. Y.

Same vs. *Same* (1920), 254 U. S. 647, Certiorari denied.

The great point in these cases is their following by citation the Perkins case, leading to decisions against the beneficiary.

In Re Sherman Estate 3rd Dept. N. Y. 179 App. Div. 497 (166 N. Y. Supp. 19, 24).
Ditto affirmed no opinion 223 N. Y. 540.

This is another case following by citation the Perkins, Penfold and other cases that held that the Federal Estate tax is not deductible from State Transfer Tax.

In Re Hazard 188 App. Div. 69 (177 N. Y. Supp. 369) 4th Dept. N. Y.

This holds that the N. Y. Transfer tax is not on property but the privilege of transfer. That it is based on the value at death.

In Re Hamlin 185 App. Div. 153 (172 N. Y. Supp. 787 and foot 789 and 790).

4th Dept. Held that the Fed. Estate Tax will not be deducted as to State Transfer Tax and that the former is payable out of the "residue" of the Estate.

In Re Hamlin affirmance of last case 226 N. Y. 407, 416.

There is an opinion by Hogan, *J.*

All these cases follow the Merriam Case (afterwards in name of Perkins U. S. ct.) and the Swift case.

We turn for variety to some cases arising in other States but along same lines:

Finnens Estate, 196 Pa. 72.

This holds that the Penn Estate tax follows the Estate for payment primarily rather than beneficiaries.

Jackson vs. *Meyers*, 257 Pa. 104, 107.

This case calls attention to the requirement of the act that the Executor pay the tax. The decision is like the Finnen Estate case, that the act makes the tax a lien on the estate primarily rather than on the legacies.

Corbin vs. *Townsend*, 92 Connecticut 501.

This case decides that both Federal and State inheritance taxes are "expenses of administration and to be deducted from the appraised value of the estate."

Hooper's Executors vs. *Shaw* cited in the above Connecticut case is 176 Mass. 190 (March 1900).

It decides that a legacy tax paid to the U. S. is to be deducted before paying the State succession tax.

The opinion by Holmes, Chief Justice, says:

> "Whatever the nature of the State Succession tax it is admitted and is obvious that the value of the property concerned is made measure of the tax. This appears from the words of the Act, which also show at what moment the value is to be taken. The words are 'property * * * which shall pass * * * to any person'. Without throwing doubt upon the power of the State to adopt a harsher rule, such as has been applied by some of the Surrogates in New York we are of opinion that these words most naturally signify the property which the legatee would get were it not for the State tax imposed by the sentence in which the words occur."

See In Re Merriam, 141 N. Y. 479, 484 S. C. Sub. nom. *United States* vs. *Perkins*, 163 U. S. 625, 630. It already has been decided upon this ground that ex-

penses of administration are to be deducted. *Callahan* v. *Woodbridge,* 171 Mass. 595, 599, 601.

> "The question is not one of procedure between the commonwealth and the United States as was put by the Assistant Attorney General. It is in substance one of Justice and in form one of Construction."

In *South Carolina* vs. *United States,* 199 U. S. 437, the opinion of the Court states:

> "Further it may be noticed that the tax is not imposed on any property belonging to the State, but is a charge on a business before any profits are realized therefrom. In this it is not unlike the taxes sustained in United States *v.* Perkins, 163 U. S. 625."

We now take up in their order the three major cases first referred to in this brief: Woodward, Home Trust and Prentiss.

In *United States* vs. *Woodward,* 256 U. S. 632, this Court strongly rejected the claim of the Government that the Estate Tax was not deductible for the purposes of the Federal Income Tax. That was the first victory in this Court of the taxpayer in his struggle for a fair construction of the provision of the income tax law permitting the deduction of Inheritance taxes paid. As indeed it was the first time that the question had fully and fairly come before the Court.

It is true and notable also that the Court of Claims against strong pressure and the weight of the World War time prejudice against any claim on the Government, had made a similar decision. It being on the Government's appeal in that case that the Woodward case so called was decided in this Court.

> *Woodward* vs. *United States,* 56 Court Claims 133.

This Court in the Woodward case after referring to the provision which is the very one involved in this case (said page 634):

> "This last provision is the important one here. It is not ambiguous, but explicit and leaves little room for construction. The words of its major clause are comprehensive and include every tax which is charged against the estate by the authority of the United States. The excepting clause specifically enumerates what is to be excepted. The implication from the latter is that the taxes which it enumerates would be within the major clause where they not expressly excepted, and also that there was no purpose to except any others. Estate taxes were as well known at the time the provision was framed as the ones particularly excepted. Indeed, the same act, by Sections 400-410, expressly provides for their continued imposition and enforcement. Thus their omission from the excepting clause means that Congress did not intend to except them."

This Court then stated briefly that the estate tax is a "tax", is a charge upon the estate, and is to be paid out of it "substantially as other taxes and charges are paid." All of this, we submit, applies equally to the New York transfer tax. Certainly, it is true tha inheritance taxes were so well known at the time that Congress used the words under construction that, as the Supreme Court said of estate taxes, "their omission from the excepting clause means that Congress did not intend to except them."

In *Home Trust Company* v. *Law*, 204 App. Div. 590 (affirmed, 236, N. Y. 607), it was held that the New York transfer tax is deductible by the estate for purposes of the New York income tax. The Court referred to the Woodward case and said that if the New York transfer tax and the Federal estate tax

"are taxes of an identical or similar nature, we have in the case of United States *v.* Woodward (*supra*) a very definite precedent for drawing the conclusion that a transfer tax paid by an executor under the laws of this State during a given year is deductible from the gross income of the estate for the year in order to determine the State income tax due from the estate in that year."

After an examination of the two statutes, the Court reached the conclusion that "the intrinsic nature and purpose of the tax is the same in either case." Then, after referring to *United States* v. *Perkins*, 163 U. S. 625, the Court said (page 593):

"It follows from the decision that the present New York State transfer tax is not a tax upon legacies or legatees; therefore, that a legatee is not entitled to a deduction of such taxes paid, or any part thereof, in a calculation of his personal net income for income tax purposes."

In conclusion the Court said (page 594):

"Aside from authority and theory we think it was the clear legislative intent, as indicated by the various provisions of the Tax Law, that in calculating the net income of the estate of a decedent for income tax purposes, the amount paid by an executor during the year in satisfaction of a transfer tax should be deducted. The income tax payment is made by the executor of the estate from funds of the estate and not from funds belonging to legatees (Kings County Trust Company *v.* Law, 201 App. Div. 181). The Transfer tax payment is made by the executor from the funds of the estate. 'The transfer tax is imposed upon the estate of the decedent as it exists at the hour of his death, and its value is to be fixed as of that time.' (Matter of Hub-

bard, 234 N. Y. 179.) Thus the tax is measurable not by the funds received by a legatee, but by the funds the executor receives. As the burden of paying the income tax, as well as the burden of paying the transfer tax, is cast upon the executor, and as the taxable income of the estate is under the terms of the Tax Law measurable by gross income received less taxes paid, it would seem clear that the person paying the income tax, namely, the executor, is entitled to deduct the very transfer tax which he himself pays."

As to the respect held by the United States Courts for such decisions, this Court has said:

The Court, per Holmes, Justice:

"While it is true we are not bound by the construction of the New York Statutes by the New York Courts in deciding the constitutional question, yet when we are dealing with a matter of local policy like a system of taxation, we should be slow to depart from their judgment, if there was no real oppression or manifest wrong in the result. Troy Union R. R. Co. *v.* Mealy, 254 U. S. 47, 51."

Fairfield vs. *County*, 100 U. S. 48.

People ex rel. Clyde vs. *Gilchrist*, 262 U. S. 94, 97.

Many more similar cases could be cited. The general rule is too well known to call for them.

We Turn to the Prentiss Case in the U. S. Courts.

The argument that the New York transfer tax is deductible by the beneficiaries of the estate rather than by the estate is not open to the Government. The Second Circuit has decided, and this Court by denying a writ of certiorari has affirmed, that the New York transfer

tax is not deductible by the beneficiaries of the estate. (*Prentiss* v. *Eisner*, 267 Fed. 16; 254 U. S. 647.) The reasoning of the Circuit Court of Appeals in the Prentiss case thus leads to the Conclusion that the tax is deductible by the estate. After stating that *Matter of Penfold*, 216 N. Y. 163, decided that "the transfer tax is not a tax upon property but upon the right of succession to property," the Circuit Court of Appeals said (page 21):

> "Now a succession tax is a tax upon a transfer of property in general, and as such is distinguishable from a legacy duty, which is a tax upon a specific bequest. Under the New York law the succession tax creates a lien upon the estate of the decedent at the moment of his death. The right of the state to the amount of this lien attaches at that time, and it must be paid before the transferee, legatee, or devisee ever gets anything, and the executor or administrator is personally liable for the tax until it has been paid. Under such a law we do not see that the transferee pays the tax."

In conclusion that Court said:

> "The legacy which the plaintiff herein received under the will of her father did not become her property until after it had suffered a diminution to the amount of the tax, and the tax that was paid thereon was not a tax paid out of the plaintiff's individual estate, but was a payment out of the estate of her deceased father of that part of his estate which the State of New York had appropriated to itself, which payment was the condition precedent to the allowance by the state of the vesting of the remainder in the legatee."

It would seem that the Prentiss case effectually answers the whole argument of the Government. If we

understand that argument correctly, it is that Congress intended that there should be deducted from the income of the estate only the taxes which were an obligation of the estate regarded as a whole, and that the New York transfer tax is not such a tax but is an obligation placed upon the various items of property constituting the estate. But as before cited the Prentiss decision said that the New York tax "is a tax upon a transfer of property in general, and as such is distinguishable from a legacy duty, which is a tax upon a specific bequest." The New York Court of Appeals by affirmance has said substantially the same thing in the Home Trust Company case: "The transfer tax payment is made by the executor from the funds of the estate. * * * Thus the tax is measurable not by the funds received by a legatee, but by the funds the executor receives."

If the contention of the Government in that case was correct, the New York transfer tax is deductible neither by the estate nor by the beneficiary. Yet the Federal income tax statute says that in computing the net income of a taxable entity there may be deducted "taxes * * * (except income and excess profits taxes)," and this Court said in the Woodward case that the implications from the exception of certain taxes is "that there was no purpose to except any others." That the implication which this Court so drew was correct has been demonstrated by the fact that five months after the decision in the Woodward case Congress passed the Revenue Act of 1921, containing precisely the same provision and has recently re-enacted it in the Revenue Act of 1924.

See also:

Matter of Swift, 137 N. Y. 77.
Matter of Merriam, 141 N. Y. 479.

Matter of Sherman, 179 App. Div. 497, affd. 222 N. Y. 540.

Matter of Hamlin, 185 App. Div. 153 affd. 226 N. Y. 407.

Matter of Hazard, 188 App. Div. 869.

Edwards vs. *Slocum*, 264 U. S. 61.

Finnens Estate, 196 Pa. 72.

Jackson vs. *Meyers*, 257 Pa. 104, 107.

Corbin vs. *Townsend*, 92 Conn. 501.

Hooper Exrs. vs. *Shaw*, 176 Mass. 190.

South Carolina vs. *U. S.*, 199 U. S. 437.

Y. M. C. A. vs. *Davis*, 264 U. S. 47.
and *U. S. Tax Cases*, 2nd Supp. 1583, p. 51.

Montgomery (*Fed. Taxation*), Ed. 1925, pp. 974, 975.

The opinion of the Appellate Court below clears the case of all questions by its sagacious outlook and the taking of an allround view.

In it the word "imposed" as to taxes upon the Estate is dwelt upon (Record pp. 18 to 20).

Here it should be well considered that the estate of a decedent in process of settlement—before distribution—is a clear separate entity carefully provided for and the express creation of the statute as the Government's brief admits.

An important point in this connection is that the operation of the tax is not postponed until the Executor receives any property. The axe descends with the last breath of the decedent. The Executor takes the Estate charged with the Inheritance tax on all the property that existed then.

POINT II.

The theories which the Government advances are mere metaphysics and the precedents upon which it relies have been disputed right along by other cases or are not in point.

The theory of Petitioner's argument is founded on the idea that the New York Transfer Tax cannot be deducted from a Federal return of income if it is of such a nature that it may not be deducted (under the reasoning of the cases it cites) for purposes of the Federal Estate Tax. In that respect it claims that the New York State transfer act taxes the individual interests in a decedent's estate rather than the estate as a whole and therefore on that account the beneficiary only is entitled to a deduction from his income of the inheritance tax paid even though it was paid by the executor or administrator of the estate.

It especially in that regard cites and relies on the following cases:

> *In Re Gihons Estate*, 169 N. Y. 443, 62 N. E. 561.
> *Knowlton* vs. *Moore*, 178 U. S. 41.
> *New York Trust Co.* vs. *Eisner*, 256 U. S. 345.

As these cases have recently all been closely reviewed and considered by the Board of Appeals and its conclusions are to be printed as a part of this brief and those conclusions appear fair, they are referred to to avoid duplication.

> See Appeal of the *Farmers Loan & Trust Co. Case Decision*, No. 1052, Board of Tax Appeals, p. 3578, of 3 Commerce Clearing House Service.

The Respondent however more particularly relies upon the statement and conclusion as to the *New York Trust Co. case* in the opinion written by Judge Learned Hand in the Court below.

See Record, foot p. 19.

None of these cases—Gihon &c. are Income tax cases, but Inheritance tax. The decisions do not affect the case at bar. The reasoning in them is what Petitioner grasps at. It is not at all vital here. It does not always harmonize fully, it is quite true with the long line of decisions cited by Respondent in this Court and other jurisdictions. No recent cases have fully followed their particular reasoning.

Newer citations by Petitioner:

In Re Meyer and Smith vs. *Browning,* 209 N. Y. 386, 103 N. E. 713; 225 N. Y. 358, 122 N. E. 217.

There is nothing as to these cases bearing on this case.

Carroll County vs. *Smith,* 111 U. S. 556.

This case is on the point that in exceptional cases there may be reasons not to follow State Court decisions on their state matters.

United States v. *Railroad Co.,* 17 Wall. 322.

This is a case something like the Bank stock cases. Here interest on Bonds issued by the Railroad for debts due was taxable at the rate of five per cent and the holders of the Bonds were taxed rather than the Railroad—the Railroad paying and then suing the Government to get it back.

Northern Trust Co. v. *McCoach,* 215 Fed. 99.

National Bank of Commerce v. *Allen,* 211 Fed. 743, 746, affirmed 223 Fed. 472, 477.
First National Bank v. *McNeel,* 238 Fed. 550, 560.
Elliott National Bank v. *Gill,* 218 Fed. 600, 601.

The above Bank Stock cases have not been taken very seriously by any as important in these Income or Inheritance tax suits. The Corporations paid the tax on their shareholders stock but were not permitted to deduct it. There is no analogy between that class of cases and the case at bar. There the tax is clearly imposed on the individual stockholders and not upon the corporation which is required to pay it because that is a convenient way to collect it. The corporations had the unquestioned right to deduct the tax from stockholders' dividends or otherwise to obtain reimbursement. But the outstanding feature which distinguishes these cases from the present case is that there the question was whether the corporation or the stockholders was entitled to deduct the tax, whereas here the question is whether the estate may deduct the tax or whether no one can deduct it.

The other theory of Petitioner if it be separate from the one before referred to being that the New York Inheritance tax was not a "charge on the estate" is mixed with the one hereinbefore commented on, and the cases relied on by either side are the same. The cases relied on in both instances by Respondent are those cited in Point I.

As to the *Farmers Loan and Trust Company* vs. *Winthrop,* 238 N. Y. 488, 498, a fair comment is that the rule in the Home Trust Case was not meant to be reconsidered; that case and rule not being brought before the court.

However, the newer, broader-spirited contention of

the Government as to the stand it takes is summed up at the end of the Brief as follows, p. 25:

> "The contention is that the tax *must reduce* the assets of the Estate available for distribution and that so long as the estate is entitled to reimbursement, as it is under the New York law, it is not, in theory or in practice, reduced by the payment."

That seems to make this Appeal very fairly and easily decidable. Look at the facts: The executor is obliged to pay out of the Estates general funds the tax. That certainly reduces the estate. Does he get the money back from anyone? No! As against all persons interested in the Estate this payment is conclusive. They never had an interest in the estate so far as to include the Executor's tax payment. No receipt is needed from them. The Executor's voucher is his evidence of payment of the tax. The only thing is to calculate how much of the Estate left comes to each. It may be nothing as explained elsewhere here. The idea of "reimbursement" by any legatee or distributee has no foundation. The Executor, it is true, has to protect himself in the machinery of the Probate Courts by having the Estate appraised and an order of the Court made reciting the correct sum of the Estate Tax as to each person interested. Such order and the State Comptroller's receipt cover the case. In no case following the law do beneficiaries receive anything from the estate for which they are required to reimburse the Executor except in the case of devises of chattels not money where an exception is made apparently to cover heirlooms spoken of elsewhere in this brief to avoid a forced sale of them by the Executor. The Petitioner's Counsel does not rely on so small a point as that, it is fair to opine.

The Government Counsel has in his mind the reim-

bursement idea from the cases involving both the Federal Estate Tax and the State Inheritance Tax. In the former in the case of a Will, by the law the tax is all paid by the residuary part of the estate. As to the State Tax the rule as is well known is quite different, the tax being graduated by relationship, is divided into as many shares as interests though paid in one sum. The term that the estate is "reimbursed" has grown up as to the latter or State payment. Those beneficiaries do not get something (looked at in one way) for nothing, while the Federal beneficiaries (except the unfortunate "residuaries") do. But in sober earnest the State beneficiaries also do for all their interest is pure gift and the tax comes before they get it.

The small detail provisions spoken of in Petitioner's brief (p. 19) relating to making the beneficiary personally liable for the tax on his share and providing that the Executor where the bequest is of articles, not money, is to collect from the beneficiary the tax (evidently to prevent forced sale of heirlooms); and that if an estate apparently distributed) proves insufficient to pay debts and the legatee is compelled to refund a part of his legacy, he is entitled to recover from the Tax Commissioner a pro rata part of the tax paid,—are simply working details not bearing on the great questions of the Act. By the way the return last spoken of is directed to be paid to the Executor by the Section 225 of the Act cited by Petitioner unless the tax has actually been paid by the beneficiary—not a thing to be expected.

As to Petitioner's Points as to realty where the executor is not the successor, or specific legacies, and it may be added as to any real estate in the case of administrators.

• (Foot page 30, and pages 30 and 31.)

As regards real estate (which does not go to an Ad-

ministrator at all) and real estate specifically devised to persons other than the executors or trustees by a Last Will, let it be said that no point arises in this case,—which is that of an Administratrix, who takes only personal estate.

The suppositious cases suggested in Petitioner's brief (pages 31, 32) would all be met by the machinery provided by the respective statutes and the implied powers following all great schemes of Government.

The Respondent's reply may be well amplified as follows:

At the very end of the Government's brief, the argument is made that, so far as the New York transfer tax is imposed on real estate, it ought not to be deductible by the estate because the real estate vested immediately in the beneficiaries and never became a part of the estate in the hands of the executor. It is then argued that since it would be very difficult to separate the tax on real estate from the tax on personalty, no part of the tax should be deducted. This may fairly be described as an attempt to make the tail wag the dog. But the argument lacks strength in other respects. In the first place, it is comparatively simple to allocate the tax even in the most complicated case. If a beneficiary receives $100,000 worth of real estate and $100,000 of personalty, and the New York transfer tax amounts to $8,000 it is true that it is impossible to say whether the higher rates applying when the value passes $100,000 applies to the real estate or to the personalty, but all that need be done is to allocate the total tax between the two classes of property in the proportion to their respective values. Thus, in the case put, $4,000 of the tax would be allocatable to the real estate and the same amount to the personalty. In the second place, it may be well to call to the attention of the Court that, in the case at bar, the decedent owned no real estate, so that the point does

not arise. Reference may also be made to the opinion of the District Court in *Farmers Loan & Trust Co.* v. *United States,* Corporation Trust Company Income Tax Service, p. 1082 (D. C., S. D. N. Y.), (Appendix, p. 28), where it was held that the transfer tax on real estate is deductible by the estate in determining net income.

Finally, the whole older theory of the appellant is founded upon the erroneous idea that the New York transfer tax cannot be deducted from a Federal return of income if it is of such a nature that it may not be deducted for purposes of the Federal Estate Tax.

However, the carefully worded, broader-spirited final statement of Petitioner's contention at page 26 of its brief hereinbefore cited and considered does not go so far.

The Claim that the New York Inheritance Tax is Vitally Different from the Federal One Has No Foundation.

That the acts are in principle vitally alike is settled by common knowledge and legal precedent.

> *Home Trust v. Law,* 204 App. Div. 590; 236 N. Y. 607.
>
> See Citations Federal Act, Secs. 201, 203, 204, 207, pp. 25, 26.
>
> See Citations New York State Act, pp. 25, 26.
>
> Secs. 220, 222, 223, 224, printed in Petitioner's Brief, pp. 35 to 43.
>
> Secs. 230, 231 omitted there see this brief, p. 26.

POINT III.

Statutes imposing taxes are to be construed strictly against the Government.

In the *Gould case* (1917) Justice McReynolds, writing for this Court at page 153, said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen. U. S. *vs.* Wigglesworth, 2 Story 369; American Net &c. Co. *v.* Worthington, 141 U. S. 468 and 474; Benziger *v.* U. S., 192 U. S. 38, 55."

Gould vs. *Gould,* 245 U. S. 151.
Black on *Income and Other Fed. Taxes,* 4th Ed., Sec. 27.

Conclusion.

The decision of the Circuit Court of Appeals should be affirmed. The order of the District Court overruling the demurrer and the judgment thereon should be affirmed and costs should be awarded to the respondent.

Respectfully submitted,

SIDNEY V. LOWELL,
Counsel for Respondent.

HARRISON TWEED,
BENJAMIN MAHLER,
also of Counsel.

APPENDIX A.

STATUTES INDIRECTLY INVOLVED.

1st. Certain Provisions as to U. S. Estate Tax from U. S. Statutes.

Sec. 201. That a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the value of the net estate to be determined as provided in section two hundred and three, is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this act, whether a resident or non-resident of the United States.

(All of first paragraph.)

(Here follow percentages of from one to fifteen per cent on sums from commencing at $50,000 and all above $5,000,000.)

Sec. 203. That for the purpose of the tax the value of the net estate shall be determined.

a. In the case of a resident, by deducting from the value of the gross estate—

1. Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgage losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; and

2. An exemption of $50,000.

(All of first four paragraphs.)

Sec. 204. That the tax shall be due one year after the decedent's death. If the tax is paid before it is due a discount at the rate of five per centum per annum calculated from the time payment is made to the date when the tax is due shall be deducted.

(All of first two sentences.)

Sec. 207. That the executor shall pay the tax to the collector or deputy collector.

(All of first sentence.)

All the above from U. S. Statutes at Large, Volume 1915-1917. All being of 1916 except that 201 is given as amended 1917. (Public Laws, Part I.)

The following are extracts from the Statutes of the State of New York as to inheritance or "transfer" taxes; being in addition to the extracts from such statutes printed in Appendix A of Petitioner's Brief.

Sec. 230. *Proceedings by appraiser.* (First paragraph, second sentence). The Surrogate either upon his own motion, or upon the application of any interested person, including the State Comptroller, shall by order direct the person or one of the persons appointed pursuant to section two hundred and twenty-nine of this article in counties in which the office of appraiser is salaried and in other counties, the County Treasurer to give the fair market value of property of persons whose estates shall be subject to the payment of any tax imposed by this article.

Every such appraiser shall forthwith give notice by

mail to all persons known to have a claim or interest in the property to be appraised, and to such persons as the Surrogate may by order direct, of the time and place when he will appraise such property (second paragraph, first sentence).

The report of the Appraiser shall be made in duplicate, one of which duplicates shall be filed in the office of the Surrogate and the other in the office of the State Comptroller (last paragraph of text of section).

Tax Law (Laws 1909, Ch. 62, Consol. Laws, Ch. 50) as amended by Tax Law amdt., 1916, p. 719, by Chap. 550, Sec. 1.

Sec. 231. *Determination of Surrogate.* From each report of Appraiser and other proof relating to any such estate before the Surrogate, the Surrogate shall forthwith, as of course, determine the cash value of all estates and the amount of tax to which the same are liable; or the Surrogate may so determine the cash value of all such estates and the amount of tax to which the same are liable, without appointing an appraiser (first paragraph of text of section).

Tax Law (Laws of 1909, Ch. 62, Consolidated Laws) as amended by

Tax Law Amendment, 1916, p. 721, by chapter 550, Sec. 2.

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APPENDIX B.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

THE FARMERS' LOAN AND TRUST COMPANY and MORITZ WORMSER, as Executors of the Estate of JULIA SELIGMAN,

Plaintiffs,

vs.

THE UNITED STATES,

Defendant.

Action at law by the executors of the Estate of Julia Seligman to recover from the United States the sum of $4,741.75, with interest, alleged to have been erroneously assessed and collected as an income tax upon the Estate of Julia Seligman, deceased, under the provisions of the Revenue Act of 1921. Upon the pleadings both parties moved for judgment.

GELLER, ROLSTON & BLANC, attorneys for the plaintiffs (C. Alexander Capron and Russell L. Bradford, of counsel.)

EMORY R. BUCKNER, United States Attorney, for the defendant (F. C. BELLINGER, Assist. U. S. Attorney, A. W. GREGG, Solicitor of Internal Revenue, and THOMAS H. LEWIS, JR., Special Attorney, Bureau of Internal Revenue, of Counsel.)

THACHER, *D. J.*: Julia Seligman, a resident of New Jersey, died on or about the 28th day of March, 1921. Among the assets of her estate were the following: Real estate in New York State of the value of $160,000; personal jewelry in New York State of the value of $61,500. Under the terms of her will the New York real estate was devised to a named devisee, and the jewelry was bequeathed to named legatees. The will

granted to her executors the power to sell real estate, and directed that all transfer and inheritance taxes should be paid from the residuary estate. The executors paid the New York transfer taxes upon the transfer of the real estate and jewelry, and in making return of the net income of the estate for Federal income tax purposes deducted the amount thereof. This deduction was disallowed, additional taxes were assessed, and these taxes were paid under protest. The sole question presented for decision is whether or not such taxes are deductible in estimating the net income of the estate under the Revenue Act of 1921.

In *Keith* v. *Johnson*, 3 Fed. (2d) 361, the Circuit Court of Appeals in this circuit has decided that New York transfer taxes imposed upon the transfer of personalty not specifically bequeathed are deductible by the executors of the estate in making return of the net income of the estate under the income tax provisions of the Revenue Act of 1918 [1916-1917 Act]. The question whether such taxes, based upon the transfer of real estate or of personal property specifically bequeathed, might thus be deducted, was not decided in that case, and was expressly reserved in the opinion of the court. The questions there reserved now arise for decision under the Revenue Act of 1921. Section 219 of that Act provides: "(a) The tax imposed by Sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including (1) Income received by estates of deceased persons during the period of administration or settlement of the estate . . . (b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in Section 212, except (the exceptions being inapplicable in this case)." By Sections 210 and 211, normal taxes and surtaxes are imposed upon "the net income of every individual." The term "net income" as defined in Sec-

tion 212 is the gross income as defined in Section 213, less the deductions allowed by Section 214. Among the deductions allowed by Section 214 is the following: "(3) Taxes paid or accrued within the taxable year except (the exceptions being inapplicable here) . . . For the purpose of this paragraph estate, inheritance, legacy and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes."

It is insisted in behalf of the Government that the New York transfer tax paid upon the transfer of personal property included in a specific legacy, or upon the transfer of real estate, must be excepted from the rule in *Keith* v. *Johnson, supra,* because it is contended that when such taxes are paid by the executor they are not paid for the account of the estate or entity upon which the Federal income tax is levied, and therefore are not deductible in determining the net income which is the basis of the tax. In support of this contention it is claimed that in the case of a legacy of specific personal property the executor may require payment of the amount of the tax from the legatee before delivering the legacy, and that in the case of a legacy charged upon or payable out of real property he may require payment from the heir or devisee. (Section 224 of the Tax Law of the State of New York.) In each case it may be said the beneficiary receives specific property, and is obligated to pay the executor the transfer tax thereon. Because specific property is received without deduction of the tax it is argued that the tax when paid by the executor is not paid for the account of the estate, but for the account of the legatee.

The argument is plausible, but I believe unsound, because it rests upon the form, not upon the substance, of the transaction. In its consideration the court is bound by decisions which while not deciding the precise point here in question are in their logical implications of controlling significance. In *U. S.* v. *Perkins,* 163 U. S. 625,

it was held that a legacy to the United States was subject to the New York transfer tax upon the theory that the tax was not a tax upon the legacy, but was "in reality a limitation upon the power of the testator to bequeath his property to whom he pleases; a declaration that in the exercise of that power he shall contribute a certain percentage to the public use; in other words, that the right to dispose of his property by will shall remain, but subject to a certain condition that the state has a right to impose. . . . Thus, a tax is not upon the property in the ordinary sense of the term, but upon the right to dispose of it, and it is not until it has yielded its contribution to the state that it becomes the property of the legatee." In *Prentiss* v. *Eisner,* 267 Fed. 16, following the reasoning in *U. S.* v. *Perkins,* supra, it was held that a legatee could not deduct the New York inheritance tax upon his Federal income tax return. In *U. S.* v. *Woodward,* 256 U. S. 632, it was held that Congress did not intend to except Federal inheritance taxes deductible under the income tax provisions of the Revenue Act of 1918, and that such taxes were deductible by the executors in making return of the income of the estate. In *Home Trust Co.* v. *Law,* 204 App. Div. 590 (affd. 236 U. S. 607), the New York inheritance tax was allowed a deduction in computing the net income of a decedent's estate under the provisions of the New York income tax law, which are substantially similar to the provisions of the Federal income tax law. In that case the court regarded the State transfer tax and the Federal estate tax, although differing in respect to the rates charged, the exemptions permitted and the deductions authorized, as well as in other particulars, as of the same intrinsic nature and purpose, and it was concluded "that since the one tax is deductible from the gross revenue to determine the taxable net income of an estate under the Federal law, the other tax should be held to be deductible to determine the taxable net income of an estate under the state law." As already

noted, in *Keith* v. *Johnson,* supra, the Circuit Court of Appeals of this circuit held that the New York transfer tax paid by the executors upon the transfer of personal property not specifically bequeathed is deductible by the executors in estimating the Federal income tax upon the estate.

The New York transfer tax is neither a tax on the property or donee, and so far as the donee is concerned he does not pay a tax, but receives his legacy or devise diminished by the amount of the tax which is deducted therefrom. Judge A. N. Hand, writing in *Prentiss* v. *Eisner,* in this court (260 Fed. 589), said:

> "To say that the legatee, devisee, heir, or distributee receives the property without any deduction and then pays the tax is really a most artificial way of viewing the transaction. In the case of personal property he really only gets the balance, with a credit as a matter of convenient bookkeeping to the amount of the tax. In the case of real estate he receives properly speaking an equity. He can pay the tax and get the land freed from the incumbrance, or the state can foreclose the lien and he will receive the balance. In either case the only natural way to treat him is as a recipient of a net amount. The condition of the devolution of the property is the receipt of the transfer tax by the state."

So far as the executors are concerned, their payment to the State of this deduction from the principal of the gift is regarded as the payment of a tax which they may deduct from the income of the estate. However illogical it may seem to thus treat the tax as a deduction from the principal of the legacy and at the same time to treat it as an expenditure chargeable to the income of the estate, this seems to be the law under the statute and the decisions construing it, at least to the extent of deductions made from cash legacies under Section 224 of the New York Tax Law. If there be il-

logic in this, it does not result from any inconsistencies in the decisions, but from the statute itself, which allows deductions from the gross income of all taxes paid within the year, including inheritance and transfer taxes. (U. S. *v.* Woodward, 256 U. S. 632.) This construction of the Revenue Act of 1918 is confirmed in the Revenue Act of 1921, which in terms recognizes that such taxes may be deducted in defining the time of their accrual. (See Section 214 (3) of the Revenue Act of 1921.) Since it is the law, in this court at least, that New York inheritance taxes upon general legacies are deductible, there can be no reason in excepting from this rule taxes upon the transfer of real estate or personalty specifically bequeathed, unless the exception is to be based, not upon the nature of the tax or the obligation to pay it, but merely upon the form which the transaction necessarily takes, so that the identity of specific property may be preserved. The nature of the tax is not changed by the fortuitous circumstance that the property is transferred in kind, or that the amount of the tax is refunded to the executor instead of being deducted by him before delivery of the legacy. In contemplation of law there are no distinctions except in form between the two transactions, and these distinctions are not recognized in the statute permitting the deduction. In providing for the deduction of "taxes paid within the taxable year" the statute in an excepting clause enumerates what taxes are to be excepted, which implies a purpose not to except others. (*U. S.* v. *Woodward,* 256 U. S. 632.) Such taxes as those here in question are not within the exception and the courts cannot add exceptions to those specifically enumerated by Congress. The executors were required to pay the taxes as an incident in the administration and settlement of the estate. They were paid, not for the account of the devisee and legatees, but in reality for the decedent's account as a tax upon her right to transmit. If paid by the decedent during her lifetime, there would

be no question of her right to deduct, and being imposed upon her act of transfer consummated by her death it is not without reason to permit, as the statute does, the deduction by her executors, regardless of the form in which the property passes to her legatee and devisees. The statute permitting the deduction, the nature of the tax deducted, and the obligation to pay it imposed upon the executors being precisely the same as in *Keith* v. *Johnson, supra,* I can see no reason in refusing to apply the rule of that case to the taxes here involved.

The motion of the plaintiff is therefore granted, and the motion of the defendant is denied.

U. S. BOARD OF TAX APPEALS.

Appeal of FARMERS' LOAN & TRUST COMPANY.

DOCKET NO. 1399.

Administrator, Estate of Nathaniel Whitman.

The taxpayer as administrator made return and paid tax on the transfer of the estate of Nathaniel Whitman in the year 1919 and claims the right to deduct the said tax from its return of income for the estate for the period in which the tax was paid. *Held,* that the New York state transfer tax was a proper deduction from income of an estate and that said tax is not deductible by the beneficiaries thereof.

Submitted March 18, 1925. Decided November 20, 1925.

RUSSELL BRADFORD, ESQ., *for the taxpayer.*
E. C. LAKE, ESQ., *for the Commissioner.*
Before JAMES, LITTLETON, SMITH and TRUSSELL.

This is an appeal from the determination of a deficiency in income tax for the taxable period beginning January 8, 1919, the date of the death of the decedent,

and ended December 31, 1919. The amount of the deficiency is $4,498.86.

The sole question involved in the appeal is whether the New York State transfer tax may be deducted in the determination of the net income of an estate.

Findings of Fact.

Nathaniel Whitman died a resident of the State of New York on January 7, 1919, leaving a will in which he appointed one Arthur L. Lasher as sole executor. The said Lasher acted as executor of the estate until on or about February 18, 1919, when the petitioner in this appeal, the Farmers Loan and Trust Company, was appointed as administrator with the will annexed, of the estate.

Said Lasher, on July 10, 1919, paid a transfer tax upon the estate to the Comptroller of the State of New York in the amount of $121,120.07. Under date of June 10, 1921, the Surrogates Court of New York County made final determination of the value of the estate of Nathaniel Whitman, said value being fixed at $2,500,312.45, upon which a transfer tax was assessed in the amount of $127,494.81, which tax was satisfied by the payment above mentioned because of the five per cent discount remitted under New York state law for payments within six months of the date of death.

Nathaniel Whitman died seized of real estate in New York valued at $518,200, of which $87,000 in amount was specifically devised and the tax upon which amounted to $6,496.03. The decedent further provided in his will for the conversion by the executors of all the rest and residue of his estate into cash.

Arthur L. Lasher, as executor of the estate of the decedent, made and filed in due course the income tax return of that estate for the period from the date of the death of the decedent to the end of the taxable year 1919. In making that return he did not claim as a deduction the amount of inheritance or transfer tax paid to the

State of New York. The Commissioner made other adjustments not here material or in question, and from his refusal to offset against such adjustments the transfer taxes above set forth and his determination of a deficiency consequent thereon, the taxpayer brings this appeal. The return of the estate was on the cash basis and the books were so kept.

DECISION.

The deficiency determined by the Commissioner is disallowed.

OPINION.

JAMES: The question involved in this appeal requires the construction of sections 210, 211, 214 (a) (3) and 219 (a) and (b) of the Revenue Act of 1918, and Article 10 of the Tax Law of the State of New York, being the article dealing with the subject of taxable transfers.

Sections 210, 211 and 219 of the Revenue Act of 1918 imposed taxes upon individuals, estates and trusts at rates therein named. Section 214 of that act provides in part as follows:

> "Sec. 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * * * * * * *
>
> "(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, * * * or (c) by the authority of any State or Territory, * * *"

Section 219 of that act provides in part:

> "Sec. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—
>
> "(1) Income received by estates of deceased

persons during the period of administration or settlement of the estate;

* * * * * * * *

"(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except * * *"

It appears from the foregoing that under the Revenue Act of 1918, a tax is imposed upon the net income of an estate, during the period of administration or settlement, in the same manner as upon other taxable persons and with the same definition of gross and net income and the deductions allowable from gross income in ascertaining the amount of net taxable income. Inquiry here, therefore, is whether the New York State transfer tax paid by the estate of the decedent represented in this appeal, may be taken as a deduction in ascertaining the net taxable income of that estate. The question turns upon whether the estate of Nathaniel Whitman was the taxable entity which paid the New York State transfer tax in the year 1919. The solution of this question turns upon the nature of the tax so paid as defined by the statutes of that state as interpreted by the courts of the United States and of the State of New York.

Section 220 of the New York Tax Law provides, so far as is material, as follows:

"TAXABLE TRANSFERS. A tax shall be and is hereby imposed upon the transfer of any tangible property within the state and of intangible property, or of any interest therein or income therefrom, in trust or otherwise, to persons or corporations in the following cases, subject to the exemptions and limitations hereinafter prescribed:

"1. When the transfer is by will or by the intestate laws of this state of any intangible property, or of tangible property within the state, from any

person dying seized or possessed thereof while a resident of the state."

Section 221 (a) provides the rates of tax which are based upon the amount of the legacies, bequest or inheritance of each individual beneficiary. Section 222, so far as is material to this matter, reads as follows:

> "ACCRUAL AND PAYMENT OF TAX. All taxes imposed by this article shall be due and payable at the time of the transfer, except as herein otherwise provided. Taxes upon the transfer of any estate, property or interest therein limited, conditioned, dependent or determinable upon the happening of any contingency or future event by reason of which the fair market value thereof cannot be ascertained at the time of the transfer as herein provided, shall accrue and become due and payable when the persons or corporations beneficially entitled thereto shall come into actual possession or enjoyment thereof. Such tax shall be paid to the state comptroller in a county in which the office of appraiser is salaried, and in other counties, to the county treasurer, and said state comptroller or county treasurer shall give, and every executor, administrator or trustee shall take, duplicate receipts from him of such payment as provided in section two hundred and thirty-six."

Section 224 provides for the method of collection of the tax and the persons responsible for its payment. It reads as follows:

> "LIEN OF TAX AND COLLECTION BY EXECUTORS, ADMINISTRATORS AND TRUSTEES. Every such tax shall be and remain a lien upon the property transferred until paid and the person to whom the property is so transferred, and the executors, administrators and trustees of every estate so transferred shall be personally liable for such tax until its payment. Every executor, administrator or trustee shall have full power to sell so much of the property of the decedent as will enable him to pay such tax in the same

manner as he might be entitled by law to do for the payment of the debts of the testator or intestate. Any such executor, administrator or trustee having in charge or in trust any legacy or property for distribution subject to such tax shall deduct the tax therefrom and shall pay over the same to the state comptroller or county treasurer, as herein provided. If such legacy or property be not in money, he shall collect the tax thereon upon the appraised value thereof from the person entitled thereto. He shall not deliver or be compelled to deliver any specific legacy or property subject to tax under this article to any person until he shall have collected the tax thereon. If any such legacy shall be charged upon or payable out of real property, the heir or devisee shall deduct such tax therefrom and pay it to the executor, administrator or trustee, and the tax shall remain a lien or charge on such real property until paid; and the payment thereof shall be enforced by the executor, administrator or trustee in the same manner that payment of the legacy might be enforced, or by the district attorney under section two hundred and thirty-five of this chapter. If any such legacy shall be given in money to any such person for a limited period, the executor, administrator or trustee shall retain the tax upon the whole amount, but if it be not in money, he shall make application to the court having jurisdiction of an accounting by him, to make an apportionment, if the case require it, of the sum to be paid into his hands by such legatees, and for such further order relative thereto as the case may require."

Section 225 reads in full as follows:

"Refund of Tax Erroneously Paid. If any debts shall be proven against the estate of a decedent after the payment of any legacy or distributive share thereof, from which any such tax has been deducted or upon which it has been paid by the person entitled to such a legacy or distributive share, and such person is required by order of the surrogate having

jurisdiction, on notice to the state comptroller, to refund the amount of such debts or any part thereof, an equitable proportion of the tax shall be repaid to him by the executor, administrator or trustee, if the tax has not been paid to the state comptroller or county treasurer; or if such tax has been paid to such state comptroller or county treasurer, such officer shall refund out of the funds in his hands or custody to the credit of such taxes such equitable proportion of the tax, and credit himself with the same in the account required to be rendered by him under this article. If after the payment of any tax in pursuance of an order fixing such tax, made by the surrogate having jurisdiction, such order be modified or reversed by the surrogate having jurisdiction within two years from and after the date of entry of the order fixing the tax, or be modified or reversed at any time on an appeal taken therefrom within the time allowed by law on due notice to the state comptroller, the state comptroller shall, if such tax was paid in a county in which the office of appraisor is salaried, refund to the executor, administrator, trustee, person or persons by whom such tax was paid, the amount of any moneys paid or deposited on account of such tax in excess of the amount of the tax fixed by the order modified or reversed, out of the funds in his hands or custody to the credit of such taxes, and to credit himself with the same in the account required to be rendered by him under this article, or if paid in a county in which the office of appraisor is not salaried, he shall by warrant direct and allow the county treasurer of the county to refund such amount in the same manner; but no application for such refund shall be made after one year from such reversal or modification, unless an appeal shall be taken therefrom, in which case no such application shall be made after one year from the final determination on such appeal or of an appeal taken therefrom, and the representatives of the estate, legatees, devisees or distributees entitled to any refund under this section shall not be entitled

to any interest upon such refund, and the state comptroller shall deduct from the fees allowed by this article to the county treasurer the amount theretofore allowed him upon such overpayment. Where it shall be proved to the satisfaction of the surrogate that deductions for debts were allowed upon the appraisal, since proved to have been erroneously allowed, it shall be lawful for such surrogate to enter an order assessing the tax upon the amount wrongfully or erroneously deducted. This section, as amended, shall apply to appeals and proceedings now pending and taxes heretofore paid in relation to which the period of one year from such reversal or modification has not expired when this section, as amended, takes effect."

Section 236 also contains significant provisions with respect to the duty for the payment of the tax and reads as follows:

"Receipts from County Treasurer or Comptroller. One of the duplicate receipts issued for the payment of any tax under this article, as provided by section two hundred and twenty-two, shall be countersigned by the state treasurer if the same was issued by the state comptroller, and by the state comptroller if issued by any county treasurer. The officer so countersigning the same shall charge the officer receiving the tax with the amount thereof and affix the seal of his office to the same and return to the proper person; but no executor, administrator or trustee shall be entitled to a final accounting of an estate in settlement of which a tax is due under the provisions of this article unless he shall produce a receipt so sealed and countersigned, or a certified copy thereof. Any person shall, upon the payment of fifty cents to the officer issuing such receipt, be entitled to a duplicate thereof, to be signed, sealed and countersigned in the same manner as the original. * * *

Section 243 entitled "Definitions" contains a significant definition of the word "transfer" in the following language:

> "* * * The word 'transfer', as used in this article, shall be taken to include the passing of property or any interest therein in the possession or enjoyment, present or future, by inheritance, descent, devise, bequest, grant, deed, bargain, sale or gift, in the manner herein prescribed. * * *"

At the outset it must be understood that the deductions permitted by section 214 (a) (3) of the Revenue Act of 1918 for taxes imposed by the authority of any state does not purport to permit the deduction of any taxes except those which are paid because they are obligations of the taxpayer. The section provides that "taxes * * * imposed * * *" may be deducted. To be deductible from income, therefore, the tax here in question must be imposed upon the estate or on its personal representative. It is not enough that the personal representative may be made the conduit through which, or through whom, the tax passes to the state. Since the estate is the Federal income taxpayer it must, if it may lawfully claim this deduction, also be the State transfer tax taxpayer.

The question here at issue has been before the Circuit Court of Appeals of the Second Circuit in the case of *Keith* v. *Johnson*, 3 Fed. (2nd) 361, and before the Court of Appeals of the State of New York in *Home Trust Company* v. *Law*, 236 N. Y. 607, 142 N. E. 303, affirming a decision of the Appellate Division reported in 204 A. D. 590, 198 N. Y. Supp. 710.

In the case of *Keith* v. *Johnson*, the issue was identical with that in this appeal. The Court at the beginning of the opinion quotes section 224 of the tax law as follows:

> "The tax shall be 'a lien upon the property transferred * * * and the executors * * * of every

estate so transferred shall be personally liable for such tax until its payment.' "

Referring to section 224, set out in full above, for the portion quoted, we find that the first sentence of that section reads in full as follows:

"*Every such tax* shall be *and remain* a lien upon the property transferred *until paid and the person to whom the property is so transferred*, and the executors, *administrators and trustees* of every estate so transferred shall be personally liable for such tax until its payment." (Italics indicate omitted portions, and are ours.)

Reasoning from the section as quoted by it, the Court holds that the tax is imposed upon the executor, which is true, but it is also true that in the same sense the tax is imposed both upon the property transferred and the person to whom it is transferred. It would appear that there is nothing in Section 224 which is determinative of the question here at issue. Throughout the provisions of sections 221, 224, 225, and 236, dealing with the collection of the tax, there is no intimation as to the particular entity upon which the tax *per se* is imposed. In fact, section 220 makes it perfectly clear that the tax is imposed upon an event, namely, "the transfer of any tangible property within the state and of any intangible property, or of any interest therein or income therefrom, in trust or otherwise to persons or corporations in the following cases. * * *"

The Court also in *Keith* v. *Johnson* relies upon the above case of *Home Trust Company* v. *Law*, to which reference in detail will be made later in this opinion.

The Commissioner contended in *Keith* v. *Johnson*, and in the instant appeal contends, that the tax is a proper and allowable deduction from the income of the devisee or heirs-at-laws when paid, notwithstanding the decision of *Prentiss* v. *Eisner*, 267 Fed. 16 [U. S. Tax Cases 413].

Finally, it is apparent that the court had considerable difficulty in deciding that a New York state transfer tax imposed upon the transfer of real estate was a tax upon the estate, since, strictly speaking, real property left under a specific devise never comes into the hands of the executors or administrators but passes direct to the heirs upon whom is placed the direct burden under section 224 of paying the tax upon the real property to the executor, who is charged with the duty of paying the tax in the first instance to the state. So serious did the court apparently consider this question that it concluded the opinion with the words, "We express no opinion as to the result in the cases of realty, where the executor is not the successor, or even in the case of specific legacies." It must be apparent that if the New York state transfer tax is deductible by any interest, either the estate through the executor or the legatees or heirs, it must be deductible as an entirety and not in parcels depending on the particular manner of the devolution of the property. Any other rule would be so impossible of administration as to indicate clearly that there could have been no Congressional intent to provide so complicated a method of deducting it. Consider for instance a legatee receiving real estate, a specific bequest, and a share in the residuary estate, which latter comprises both real and personal property. The New York transfer tax, like most inheritance taxes, is graduated both by the degree of relationship of the legatee or heir and by the amount of property received. The tax is computed on the aggregate amount of the transfer. In a case such as that supposed, if the intimation of the Court should lead to a separation, the person attempting to compute the proper deduction by the estate and by the legatee would be forced to determine how much of the transfer tax imposed in bulk was imposed (1) upon a specific legacy, (2) upon the real property passing direct, (3) upon the real and personal property comprising the legatee's share of the residuary

estate, and to make the matter more complicated, we may assume that a satisfactory division among all the shares in the residuary estate was arrived at and they took undivided interests in the real property included therein.

The Court of Appeals wrote no opinion in *Home Trust Company* v. *Law*. The Appellate Division of the Supreme Court, however, wrote a carefully considered opinion, in which it held that under the New York State income tax law, imposed under provisions of law almost identical with those of the Federal law, the transfer tax was properly deductible from the income of the estate and not from the income of the individual legatees and devisees or heirs. After discussing a number of New York cases to which reference is made below, the Court said:

> "The transfer tax payment is made by the executor from the funds of the estate. * * * The tax is measurable, not by the funds received by a legatee, but by the funds the executor receives. As the burden of paying the income tax, as well as the burden of paying the transfer tax, is cast upon the executor, and as the taxable income of the estate is under the terms of the Tax Law measurable by gross income received, less taxes paid, it would seem clear that the person paying the income tax, namely, the executor, is entitled to deduct the very transfer tax which he himself pays."

We believe the foregoing states succinctly the sound basis for the determination in this appeal. It is not that the tax is made a burden upon the executor or the estate as such of the legatees, devisees or heirs as such, but that primarily the state looks to the executor and to the estate for the payment of the tax. Being a tax measured, unlike the Federal estate tax, by the amount transferred to each individual beneficiary, the New York transfer tax has quite properly provided the machinery whereby each individual beneficiary receives

his share diminished by the tax upon that share. But this does not necessarily mean that the tax is either paid by the beneficiary or imposed upon him. He receives his legacy diminished by a tax subtracted therefrom before his right attaches, although measured by the legacy itself. *In re Swift's Estate*, 137 N. Y. 77, 32 N. E. 1096; *In re Penfold's Estate*, 216 N. Y. 163, 110 N. E. 497; *In re Merriam's Estates*, 141 N. Y. 479, 36 N. E. 505, affirmed in the Supreme Court of the United States under the title of *United States* v. *Perkins*, 163 U. S. 625 [Supp. U. S. Tax Cases 993].

The last case above mentioned involved a legacy left by Merriam to the United States and included both real and personal property. It is much relied upon by the taxpayer in this appeal, as indicating that the tax is upon the estate both because of the language in the decision of the New York Court of Appeals and because of the language of the United States Supreme Court and upon what it assumes to be a corollary that to hold that the tax is one imposed upon the devisee would involve a constitutional question by reason of the fact that the property of the United States is exempt from state taxation. Whether this is so as applied to legacies left to the United States may well be doubted, since the United States does not take in its capacity as a Government but in its capacity as a corporation.

In *Merriam's* case, the Court of Appeals said:

> "For the purpose of receiving legacies, and for many other purposes, the United States is to be regarded as a body politic and corporate."

In *South Carolina* v. *United States*, 199 U. S. 437 [Supp. U. S. Tax Cases 984], the Court said:

> "Further, it may be noticed that the tax is not imposed on any property belonging to the State, but is a charge on a business before any profits are realized therefrom. In this it is not unlike the taxes

sustained in *United States* v. *Perkins*, 163 U. S. 625 [Supp. U. S. Tax Cases 993]."

This decision, while not controlling the question before us, indicates that the thought has been that:

> "The exemption of state agencies and instrumentalities from National taxation is limited to those which are of a strictly governmental character, and does not extend to those which are used by the State in the carrying on of an ordinary private business." (199 U. S. 461.)

In *United States* v. *Perkins*, the Court said:

> "The so-called inheritance tax of the State of New York is in reality a limitation upon the power of a testator to bequeath his property to whom he pleases; a declaration that, in the exercise of that power, he shall contribute a certain percentage to the public use; in other words, that the right to dispose of his property by will shall remain, but subject to a condition that the State has a right to impose. * * * Thus the tax is not upon the property, in the ordinary sense of the term, but upon the right to dispose of it, and it is not until it has yielded its contribution to the State that it becomes the property of the legatee. * * *
>
> "We think that it follows from this that the act in question is not open to the objection that it is an attempt to tax the property of the United States, since the tax is imposed upon the legacy before it reaches the hands of the government. The legacy becomes the property of the United States only after it has suffered a diminution of the amount of the tax, and it is only upon this condition that the legislature assents to a bequest of it."

We come now to consider some of the cases cited by the Commissioner which seem at first glance to indicate a conflict in the New York decisions as to the nature of the New York tax. *In re Hoffman's Estate*, 143

N. Y., 327, 38 N. E. 311, involved the method of computing the statutory exemption of $10,000, that is, whether the said exemption applied to the individual shares or to the estate as a whole. In this case there was a life estate created for the mother of the testatrix, a further life estate to her daughter, and the remainder to her issue under certain contingencies. The Court held that there was one exemption of $10,000 and used language which seemed to indicate that the tax was upon the recipient, particularly the following language. "There are some changes of phraseology in the more important sections, but I think it remains true that the tax is one upon the right of succession, *levied upon successors in respect to the shares to which they succeed, and not upon the decedent's estate as such.*" (Italics ours.) It is manifest that the above italicized portion of the quotation of the decision is dictum wholly unnecessary to the decision in the case and quite without reflection upon the result arrived at. If the Court had said in the place of the italicized portion, "measured by the shares passing to the beneficiaries," the sense would be substantially the same in so far as it is necessary to a decision, and the case would be in agreement with the major line of New York authority.

In re Westurn's Estate, 152 N. Y. 93, 46 N. E. 315, is a case involving the method of computing the taxable estate. Since the New York transfer tax is measured by the shares passing, it necessarily follows that the law does not contain, as does the Federal estate tax law, provision for the computation of a gross estate from which the debts of the decedent and the costs of administration are deductible. In *Westurn's* estate, an expensive contest over a will resulted in unusually large costs of administration, and the question involved was whether, in computing the value of the shares passing, these expenses of administration were deductible. The real decision in the case is contained in the following language:

"The real interest passing is what remains after payment of debts and other charges. It is plainly inferable from section 225 of the act that the debts of the decedent are to be deducted in arriving at the valuation of the property and in fixing the tax. That section authorizes a proportionate amount of a tax to be refunded in case debts against the estate shall be proven after the tax shall have been paid."

But the Court also said:

"The principle that the tax is a succession tax imposed as a burden *on each person claiming succession, measured by the value of his interest and collectible out of his interest only, was reaffirmed in the case of In re Hoffman's Estate.* * * *" (Italics ours.)

That language was also quite unnecessary to the decision of the case, and was obviously used by the Court in the most general sense.

In re Gihon's Estate, 169 N. Y. 443, 62 N. E. 561, involved the propriety of the deduction of costs of temporary administration. The court held that the deduction was proper before computing the value of the taxable interests transferred, and again the Court used language which, taken out of its setting, seems to indicate that the tax is imposed upon the legatee. The case also involved the question whether the Federal inheritance tax of 1898 was deducible in determining the value of the taxable transfer under the New York law. In holding that this tax could not be deducted, the Court said:

"In our judgment, the vital error of this argument lies in the assumption that the 'taxes are primarily payable out of the estate.' The federal tax is exactly of the same nature as the state tax,—a tax not on property, but on succession; that is to say, a tax on the legatee for the privilege of succeeding to property. * * * The federal tax is

necessarily of this character; for a direct tax, unless apportioned according to population, would be repugnant to the constitution of the United States. Under that statute, also, it is the amount of the legacy, not of the estate, that determines the rate of taxation. Therefore, though the administrator or executor is required to pay the tax, *he pays it out of the legacy for the legatee, not on account of the estate.*" (Italics ours.)

But the same result would have been arrived at in the foregoing case had the Court contented itself with saying that both taxes were imposed simultaneously and both upon the shares in the estate actually transferred undiminished on account of any tax upon the transfer, upon the succession or upon the inheritance or by whatever name it happened to be described.

In *New York Trust Company* v. *Eisner*, 256 U. S. 345 [U. S. Tax Cases 370], the same confusion of thought appears where the Court says:

> "* * * if the tax attaches to the estate before distribution—if it is a tax on the right to transmit, or on the transmission at its beginning, obviously it attaches to the whole estate except so far as the statute sets a limit. 'Charges against the estate' as pointed out by the Court below, are only charges that affect the estate as a whole, and therefore do not include taxes on the right of individual beneficiaries. This reasoning excludes not only the New York succession tax but those paid to other states, which can stand no better than that paid in New York. What amount New York may take as the basis of taxation and questions of priority between the United States and the state are not open in this case."

Again the same conclusion would have been arrived at by holding that the taxes attached simultaneously on account of the transfer or succession and were not to be computed with reference to one another.

Knowlton v. *Moore,* 178 U. S. 41 [U. S. Tax Cases 289], involving the constitutionality of the Federal inheritance tax of 1898 as imposed by the War Revenue Act of that year is a most instructive decision as bearing upon the nature of inheritance, succession, transfer and estate taxes. While the actual decision of the Court in that case is not of great importance in this appeal, some of the language is helpful and significant as to the general nature of inheritance, succession, transfer and estate taxes. Thus the Court says (pp. 55, 56):

> "Thus, looking over the whole field, and considering death duties, in the order in which we have reviewed them, that is, in the Roman and ancient law, in that of modern France, Germany and other continental countries, in England and those of her colonies where such laws have been enacted, in the legislation of the United States and the several States of the Union, the following appears: Although different modes of assessing such duties prevail, and although they have different accidental names, such as probate duties, stamp duties, taxes on the transaction, or the act of passing of an estate or a succession, legacy taxes, estate taxes or privilege taxes, nevertheless tax laws of this nature in all countries rest in their essence upon the principle that death is the generating source from which the particular taxing power takes its being and that it is the power to transmit, of the transmission from the dead to the living, on which such taxes are more immediately rested."

And on page 57:

> "Confusion of thought may arise unless it be always remembered that, fundamentally considered, it is the power to transmit or the transmission or receipt of property by death which is the subject levied upon by all death duties. The qualification of such taxes as privilege taxes, or describing them as levied on a privilege, may also produce miscon-

ception, unless the import of these words be accurately understood. They have been used where the power of a state government to levy a particular form of inheritance or legacy tax has in some instances being assailed because of a constitutional limitation on the taxing power. Under these circumstances, the question has arisen whether, because of the power of the State to regulate the transmission of property by death, there did not therefore exist a less trammeled right to tax inheritances and legacies than obtained as to other subject-matters of taxation, and, upon the affirmative view, being adopted, a tax upon inheritances or legacies for this reason has been spoken of as privilege taxation, or a tax on privileges. The conception, then, as to the privilege, whilst conceding fully that the occasion of the transmission or receipt of property by death is a usual subject of the taxing power, yet maintains that a wider discretion or privilege is vested in the States, because of the right to regulate. Courts which maintain this view have therefore treated death duties as disenthralled from limitations which would otherwise apply, if the privilege of regulation did not exist. The authorities which maintain this doctrine have been already referred to in the citation which we have made from *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S. 283, 288 [U. S. Tax Cases, 2nd Supp. 1368]. An illustration is found in *United States* v. *Perkins*, 163 U. S. 625 [Supp. U. S. Tax Cases 993], where the right of the State of New York to levy a tax on a legacy bequeathed to the Government of the United States was in part rested on the privilege enjoyed by the State of New York to regulate successions. Some state courts, on the other hand, have held that, despite the power of regulation, no greater privilege of taxation exists as to inheritance and legacy taxes than as to other property. *Cope's Appeal*, 191 Penn. St. 1; *State* v. *Ferris*, 53 Ohio St. 314; *State* v. *Gorman*, 40 Min. 232; *Curry* v. *Spencer*, 61 N. H. 624. In *State* v. *Switzler*, 143 Missouri 287, the power of the legislature of Missouri to levy a

uniform tax upon the succession of estates was conceded, though such tax was declared not to be a tax upon property in the ordinary sense. The court nevertheless held that the particular tax in question, which was progressive in rate, was invalid, because it violated a provision of the state constitution; the decision, in effect, being that because the legislature and the power to regulate successions, it was not thereby justified in levying a tax which was not sanctioned by the state constitution.

"All the courts and all governments, however, as we have already shown, conceive that the transmission of property occasioned by death, although differing from the tax on property as such, is, nevertheless, a usual subject of taxation. Of course, in considering the power of Congress to impose death duties, we eliminate all thought of a greater privilege to do so than exists as to any other form of taxation, as the right to regulate successions is vested in the States and not in Congress."

We conclude, therefore, that the New York state transfer tax at least is a tax which is primarily imposed upon the transfer of an estate, the taxable portion and the rate of tax being measured by the value of the several transfers made, the executor or administrator being primarily the medium for the payment of the tax, and the tax being in the first instance payable out of the taxable shares in the estate before they are transferred. The tax is, we believe, deductible from income of the estate and not from that of the individual beneficiaries. In arriving at this conclusion, we confess some difficulty in determining that the tax is imposed upon any entity whatever in a strict sense since it is imposed really upon the happening of an event and is a true excise tax rather than a tax strictly either *in personam* or *in rem*. But excise taxes, for instance stamp taxes paid upon deeds or other instruments by an executor, would clearly be included in the category

of taxes which might be deducted in determining the net income of an estate.

The real confusion, we believe, in the New York cases and in some of the others to which reference has been made, arises from the difficulty of finding precise language to define the nature of a tax when the exact issue before the Court does not require a precise definition. In the decisions themselves we do not find conflict. We find it only in the language used by the Courts. Apparently there is a confusion under the New York law between the imposition of the tax and its incidence, and this confusion is notably found in the brief filed by the Commissioner in this appeal. Thus the Commissioner says:

> "These results necessarily follow the provisions of the New York Inheritance Tax Act. Each legatee is personally liable for the tax on his legacy. The Executor deducts the amount of the tax, not from the estate, but from the legatee's share, and if the legacy or distributive share is not in money the executor is required to collect the tax thereon from the person entitled thereto and he cannot be compelled to deliver the property until the legatee has paid the tax thereon. In the event that there are several succeeding estates in the same property the Court is empowered to apportion the tax amongst the several tenants and to determine the amount to be paid into the Executor's hands by each of them (Section 224). Manifestly these provisions are intended to impose the burden of this tax upon such legacy. They are entirely inconsistent with any idea that the burden of the tax is to fall upon the 'estate.' It is true that the estate must in the first instance pay the tax, but the incidence of the tax is not determined by its payment where the person paying is entitled to reimbursement. The incidence of the tax is determined by the ultimate liability. Under the New York Act the legatee is ultimately liable for the tax. He must pay it before he can receive his legacy. In the event

> that the estate proves insufficient to pay debts and the legatee is compelled to refund a part of his legacy he is entitled to recover from the tax commission a pro rata part of the tax paid. (Section 226.) Manifestly if the ultimate liability is not upon the legacy the recovery of the overpaid tax would be by the Executor as the representative of the estate, and not by the legatee."

But if this reasoning is sound and the incidence of the tax is to be the determining factor as to the entity by which it may be deducted from income, then the Commissioner's case falls entirely in respect of the entity which may properly deduct the Federal estate tax from an income tax return. Under the New York law the Federal estate tax has been held to be a charge upon the residuary estate, *In re Hamlin,* 226 N. Y. 407, 124 N. E. 4, and the residuary legatees receive their shares necessarily diminished on account of the imposition of the tax. If the incidence of the tax is a measure of its deductibility, then the decision in *United States* v. *Woodward,* 256 U. S. 632 [U. S. Tax Cases 580] was erroneous. The argument proves too much, and really has no bearing upon the precise question here under consideration.

> "These donees do not pay the taxes any more than they pay the funeral expenses, the lawyers, the executors and the testator's debts." *Y. M. C. A.* v. *Davis,* 264 U. S. 47 [U. S. Tax Cases 2d Supp. 1583], p. 51.

We are of the opinion that the taxpayer in this appeal is entitled to a deduction on account of the transfer tax paid to the state of New York in the year 1919, and the deficiency determined by the Commissioner herein must be disallowed.

U. S. BOARD OF TAX APPEALS.

Docket No. 442.

Appeal of EDGAR MUNSON, Executor of the Estate of HARRIET A. CURTIS, *Deceased*.

> The New York State transfer tax paid by the executor of the estate of a decedent is a legal deduction from gross income in the income-tax return filed for the decedent's estate in the process of settlement for the year in which such tax was paid, under the provisions of section 214(a)(3) of the Revenue Act of 1918.

RUSSELL L. BRADFORD, Esq., for the taxpayer, ROBERT A. LITTLETON, Esq., for the Commissioner. Submitted January 17, 1925. Decided December 1, 1925.

Before LANSDON, LITTLETON and SMITH.

This appeal is from the determination of a deficiency of $3,036.03 in income tax for the year 1920 of the estate of Harriet A. Curtis, deceased. From the pleadings and documentary evidence introduced, the Board makes the following

FINDINGS OF FACT.

1. Edgar Munson is the sole surviving executor of the estate of Harriet A. Curtis, deceased. As such executor, he made an income-tax return for the estate for the year 1920, which showed a total income of $30,196.47. From the gross income the executor claimed a deduction of $33,611.45, which represents the amount of the New York State transfer tax paid by him as executor of the estate of the decedent to the Comptroller of the State of New York on July 23 and July 24, 1920. The return showed no net income. The Commissioner amended the return by disallowing the

deduction of the $33,611.45 transfer tax paid. The deficiency in tax is due to such disallowance.

DECISION.

The deficiency determined by the Commissioner is disallowed.

OPINION.

SMITH: This appeal raises the single question of the right of an estate in the process of settlement in 1920 to deduct from the gross income shown in an income tax return of the estate for 1920 the New York transfer tax paid by the executor during the year. In accordance with the provisions of section 219 of the Revenue Act of 1918, the executor of the estate of Harriet A. Curtis, deceased, filed an income-tax return of the income of the estate for which he was acting for the calendar year 1920 and deducted from the gross income $33,611.45, which is the amount of the New York transfer tax paid by him on July 23 and July 24, 1920. This deduction was made under the provisions of section 214(a) of the Revenue Act of 1918, which permits the deduction from gross income of

> "(3) Taxes paid or accrued within the taxable year imposed * * * (c) by the authority of any State or Territory * * * not including those assessed against local benefits of a kind tending to increase the value of the property assessed * * *."

The Commissioner has disallowed the deduction on the ground that the New York transfer tax is imposed not upon the estate of the decedent but upon the heirs, legatees, or devisees; that the tax which is paid by the administrator or executor is paid by him only as agent; and that the tax is a legal deduction from the gross income of the distributees only for whom it is paid. (I. T. 1474, C. B. I-2, p. 103.)

The New York transfer tax is imposed by section

220 *et seq.*, of the New York Tax Law. In section 220 it is provided:

"A tax shall be and is hereby imposed upon the transfer of * * * property * * * to persons or corporations in the following cases, * * *

"(1) When the transfer is by will or by the intestate laws of this state, * * *

"(4) When the transfer is * * * by deed * * * intended to take effect in possession or enjoyment at or after such death. * * *

"(8) The tax imposed hereby shall be upon the clear market value of such property at the rates hereinafter prescribed."

Section 224 of the tax law reads in full as follows:

"224. *Lien of tax and collection by executors, administrators and trustees.* Every such tax shall be and remain a lien upon the property transferred until paid and the person to whom the property is so transferred, and the executors, administrators and trustees of every estate so transferred shall be personally liable for such tax until its payment. Every executor, administrator or trustee shall have full power to sell so much of the property of the decedent as will enable him to pay such tax in the same manner as he might be entitled by law to do for the payment of the debts of the testator or intestate. Any such executor, administrator or trustee having in charge or in trust any legacy or property for distribution subject to such tax shall deduct the tax therefrom and shall pay over the same to the state comptroller or county treasurer, as herein provided. If such legacy or property be not in money, he shall collect the tax thereon upon the appraised value thereof from the person entitled thereto. He shall not deliver or be compelled to deliver any specific legacy or property subject to tax under this article to any person until he shall have collected the tax thereon. If any such legacy shall be charged upon or payable out of real property, the heir or devisee

shall deduct such tax therefrom and pay it to the executor, administrator or trustee, and the tax shall remain a lien or charge on such real property until paid; and the payment thereof shall be enforced by the executor, administrator or trustee in the same manner that payment of the legacy might be enforced, or by the district attorney under section two hundred and thirty-five of this chapter. If any such legacy shall be given in money to any such person for a limited period, the executor, administrator or trustee shall retain the tax upon the whole amount, but if it be not in money, he shall make application to the court having jurisdiction of an accounting by him, to make an apportionment, if the case require it, of the sum to be paid into his hands by such legatees, and for such further order relative thereto as the case may require." (Thus amended by L. 1921, chap. 476, in effect July 1, 1921.)

The obligation for the payment of the tax is placed upon the executor, administrator or trustee. He is authorized to sell so much of the property of the decedent as will enable him to pay the tax in the same manner as he might be entitled by law to do for the payment of the debts of the testator or intestate. If a legacy be money, the executor shall deduct from the legacy such portion of the transfer tax paid or payable by him as is properly apportionable to the legacy; if the legacy is in some other form of personal property than money, the executor shall collect from the legatee the amount of the transfer tax properly apportionable to the legacy and shall not pay over to the legatee the bequeathed property until the transfer tax has been paid; if the testator has devised real property the executor shall collect from the devisee the portion of the total transfer tax properly apportionable to the real estate in question, and the tax shall remain a lien upon the real property until it is paid. If the decedent is an intestate, the

transfer tax is collected from the heirs in a similar manner.

Is the New York transfer tax thus payable by the executor, administrator or trustee such a tax as is comprehended by the words "taxes paid or accrued" contained in section 214 (a) (3) of the Revenue Act of 1918? These words are comprehensive. They include all taxes except those specifically excepted. In *United States* v. *Woodward* (1921), 256 U. S. 632, 634 [U. S. Tax Cases 580], the United States Supreme Court said, relative to the words "taxes paid or accrued within the taxable" year as follows:

> "This last provision is the important one here. It is not ambiguous, but explicit, and leaves little room for construction. The words of its major clause are comprehensive and include *every* tax which is charged against the estate by the authority of the United States. The excepting clause specifically enumerates what is to be expected. The implication from the latter is that the taxes which it enumerates would be within the major clause were they not expressly excepted, and also that there was no purpose to except any others. Estate taxes were as well known at the time the provision was framed as the ones particularly excepted." (Italics ours.)

At the time of the enactment of the Revenue Act of 1918 the New York transfer tax was as well known as the Federal estate tax; the latter was not enacted until September 8, 1916, whereas the New York transfer tax has been upon the statute books continuously from 1885. We do not think that it can be doubted that the New York transfer tax is a tax comprehended by the words "taxes paid," as used in section 214 (a) (3) of the Revenue Act of 1918.

If the New York transfer tax is deductible from the gross income of some taxpayer, from the gross income of what taxpayer is it deductible? It clearly is not deductible from the gross income of the decedent, for it

was neither paid nor accrued during the decedent's lifetime. It is deductible from the gross income of the beneficiary of the estate or is it deductible from the gross income of the estate as a taxable entity when paid by the executor, administrator or trustee during the period of settlement? The Commissioner formerly held that the tax was not a legal deduction from the gross income of a legatee or beneficiary. This was upon the theory that the amount paid as transfer tax was not in reality a *tax*. The question whether it was deductible from the gross income of the legatee or beneficiary was before the courts in the case of *Prentiss* v. *Eisner*, 260 Fed. 589, affirmed 267 Fed. 16 [U. S. Tax Cases 413]. The higher court held that the New York transfer tax was not a deduction from the income of the legatee of an estate on the ground that it was not paid by the legatee nor was the tax paid on his or her behalf. It held that the New York transfer tax is one imposed upon the right to dispose of property. This was in accordance with the decision of the United States Supreme Court in the case of *United States* v. *Perkins*, 163 U. S. 625 [Supp. U. S. Tax Cases 993], and the court said that, until the Court of Appeals of New York took a different view of the New York transfer tax from that taken by the Supreme Court of the United States in the above mentioned case, it would follow that decision. A writ of certiorari for a review of the decision of the Circuit Court of Appeals in the case of *Prentiss* v. *Eisner*, was denied by the United States Supreme Court in 254 U. S. 647.

Thereafter the United States Supreme Court rendered its decision in *United States* v. *Woodward*, *supra*, and held that the Federal estate tax was a *tax* within the meaning of the words "taxes paid," contained in section 214 (a) (3) of the Revenue Act of 1918. Thereupon, the Commissioner reached a conclusion that the New York transfer tax was also a tax deductible from gross income in an income-tax return, but held that

it was deductible from the gross income of the beneficiary and not from the gross income of an estate in process of settlement (I. T. 1474, C. B. I-2, p. 103), thus rejecting the decision of the courts in *Prentiss* v. *Eisner, supra.*

In the *Matter of Merriam*, 141 N. Y. 479, the question of the nature of the transfer tax was squarely raised in New York. The decedent, William W. Merriam, bequeathed his estate to the United States and the question arose, naturally, whether the State of New York could levy a tax on the transfer to the United States. It was held by the Court of Appeals that the tax as imposed was rightly exacted. In the course of its opinion the court said (page 484):

> "This tax, in effect, limits the power of testamentary disposition, and legatees and devisees take their bequests and devises subject to this tax imposed upon the succession of property. This view eliminates from the case the point urged by the appellant, that to collect this tax would be in violation of the well-established rule that the state cannot tax the property of the United States. Assuming this legacy vested in the United States at the moment of testator's death, yet, in contemplation of law, the tax was fixed on the succession at the same instant of time. This is not a tax imposed by the state on the property of the United States. The property that vests in the United States under this will is the net amount of its legacy after the succession tax is paid."

This case was appealed to the United States Supreme Court under title of *United States* v. *Perkins*, 163 U. S. 625, 628 [Supp. U. S. Tax Cases 993], and that court upheld the right of the State of New York to impose the tax, saying:

> "Thus the tax is not upon the property, in the ordinary sense of the term, but upon the right *to dispose of it* * * *." (Italics ours.)

After tracing the right of the State to impose restrictions on the transfer of property by descent or distribution, both in the common law and subsequent to the statute of wills enacted in the reign of Henry VIII, the court said (page 628):

> "In this view, the so-called inheritance tax of the State of New York is in reality a *limitation upon the power of the testator* to bequeath his property to whom he pleases; a declaration that, in the exercise of the power, he shall contribute a certain percentage to the public use; in other words, that the right to dispose of his property by will shall remain, but subject to a condition that the State has a right to impose. Certainly, if it be true that the right of testamentary disposition is purely statutory, the State has a right to require a contribution to the public treasury *before the bequest shall take effect.* Thus the tax is not upon the property, in the ordinary sense of the term, *but upon the right to dispose of it*, and it is not until it has yielded its contribution to the State that it becomes the property of the legatee." (Italics ours.)

The Court of Appeals of the State of New York, as late as October 24, 1922 (234 N. Y. 175), in the *Matter of Hubbard,* in speaking of the New York transfer tax, said:

> "The transfer tax is imposed upon the estate of the decedent as it exists at the hour of his death, and its value is to be fixed as of that time."

We are not unmindful of the fact that there are a number of decisions of the courts of the State of New York, which speak of the New York transfer tax as a tax upon the legatee or beneficiary. Thus, in the case of *In re Gihon's Estate,* 169 N. Y. 433, 62 N. E. 561, the court said:

> "The federal tax [section 29 of the Revenue Act of June 13, 1898], is exactly of the same nature as the state tax,—a tax not on property, but on succes-

sion; that is to say, a tax on the legatee for the privilege of succeeding to property. *Knowlton v. Moore*, 178 U. S. 41 [U. S. Tax Cases 289], 20 Sup. Ct. 747, 44 L. Ed. 969. The federal tax is necessarily of this character; for a direct tax, unless apportioned according to population, would be repugnant to the constitution of the United States. Under that statute, also, it is the amount of the legacy, not of the estate, that determines the rate of taxation. *Therefore, though the administrator or executor is required to pay the tax, he pays it out of the legacy for the legatee, not on account of the estate. The requirement of the statute that the executor or administrator shall make the payment is prescribed to secure such payment, because the government is unwilling to trust solely to the legatee.* No one questions that where a legacy is given for a specified amount the tax must be deducted from the amount of the legacy and the balance only given to the legatee. A testator may direct that the tax on a particular legacy shall be paid out of his estate; nevertheless, in reality, the tax is still paid out of the legacy, the effect of the direction of the testator being merely to increase the legacy by the amount of the tax. * * * The full amount of the legacy is in law paid to the legatee, and the deduction made from it and paid to the state or federal government is paid on account of the legatee from the legacy which he receives. * * * " (Italics ours.)

This decision was under consideration by the United States Circuit Court of Appeals in the case of *Prentiss v. Eisner*, 267 Fed. 16 [U. S. Tax Case 413], and the court said relative to it and other cases:

"We admit that the New York cases on the subject of taxable transfers are confused and not always clear and consistent. But, until the New York Court of Appeals authoritatively states that the law of New York is not what the Supreme Court of the United States said it was in the *Perkins Case*, this Court has no alternative but to hold that the New

York Transfer Tax Act does not impose a tax on a legatee's right of succession which is deductible in her income tax return. The legacy which the plaintiff herein received under the will of her father did not become her property until after it had suffered a diminution to the amount of the tax, and the tax that was paid thereon was not a tax paid out of the plaintiff's individual estate, but was a payment out of the estate of her deceased father of that part of his estate which the state of New York had appropriated to itself, which payment was the condition precedent to the allowance by the state of the vesting of the remainder in the legatee."

In *Home Trust Co.* v. *Law* (1923), 204 App. Div. 590, affirmed by the Court of Appeals without opinion, 236 N. Y. 607, the question of the character of the New York transfer tax was squarely presented to the Appellate Division of the Supreme Court of New York. The question in issue was whether the New York transfer tax paid by the executor of an estate in process of settlement was deductible from the gross income of the estate in the state income-tax return filed for the estate by the executor. The New York State income tax law was patterned after the Federal income tax law, and in all respects here material was the same as the Federal income tax law. The Appellate Division held that the transfer tax was imposed upon the estate and was therefore deductible from the gross income of the estate in process of settlement. As above indicated, this decision of the lower court was approved without a written opinion by the highest court in the State of New York.

As above noted, the United States Circuit Court of Appeals, in *Prentiss* v. *Eisner*, *supra*, stated that it had no alternative but to hold that the New York transfer tax does not impose a tax upon a legatee's right of succession which is deductible in the legatee's income-tax return unless or until the New York Court of Ap-

peals authoritatively states that the law of New York is not what the Supreme Court said it was in the *Perkins Case, supra.* Since that time the New York Court of Appeals has held not that the New York transfer tax is otherwise than what it was construed to be in the *Perkins Case*, but has put its stamp of approval upon the proposition that the tax is on the right of the decedent to dispose of property by will or to transfer title to his heirs-at-law in case the decedent was an intestate. It is a cardinal principle of statutory construction that the interpretation of a state statute by the highest court of that state is controlling upon the Federal courts. *Massingill* v. *Downs* (1849), 7 How. 760; *Des Moines National Bank* v. *Fairweather* (1923), 263 U. S. 103; *Cudahy Packing Company* v. *Parramore* (1923), 263 U. S. 418.

The exact question in point in the appeal at bar has been decided in the case of *Johnson* v. *Keith*, 294 Fed. 964. In that case the United States District Court for the Eastern District of New York held that the New York transfer tax is a tax imposed on the right to dispose of property and that it is not until the property has yielded its contribution to the State that it becomes the property of the beneficiary, and hence that the tax is payable by the estate, and not by the beneficiary. This case was appealed to the United States Circuit Court of Appeals for the Second Circuit and, on November 21, 1924, the decision of that court was handed down affirming the decision below. The Circuit Court in this case said:

> "The case at bar therefore turns on whether the New York inheritance tax is 'imposed' on him. At least, if it is so imposed, section 5 covers him. That is a question of New York law, and we are bound by the decisions of the New York Court of Appeals on that question." *Keith* v. *Johnson*, 3 Fed. (2d), 361.

We have carefully considered the arguments of the Commissioner to the effect that the New York transfer

tax paid by an executor is not a legal deduction from the gross income of the estate in an income-tax return filed for the estate during the period of settlement. His principal argument appears to be based upon language used by the United States Supreme Court in the case of *New York Trust Company* v. *Eisner*, 256 U. S. 345 [U. S. Tax Cases 370]. That court held that the New York inheritance tax was not a deduction in calculating the net estate liable to the Federal estate tax. In commenting upon this case the United States Circuit Court of Appeals for the Second Circuit, in *Keith* v. *Johnson, supra*, decided on November 21, 1924, said:

> "That case turned on the meaning of section 203 (a) (1) of the Act of 1916, especially the words 'such other charges against the estate as are allowed by the laws of the jurisdiction * * * under which the estate is being administered.' It is quite true that the reason given was that inheritance taxes were 'taxes on the right of individual beneficiaries,' and for that reason not 'charges that affect the estate as a whole.' Literally the first clause quoted contradicts *U. S.* v. *Perkins, supra*, but the cases may be reconciled by understanding that the 'charges' intended are only such as are imposed on the executor as successor *stricti juris.* like the income tax itself, and not such as arise because he must distribute the estate, as is the inheritance tax. There was reason to impute such a distinction to Congress, since the income tax is collected yearly, while the inheritance tax is levied once and for all. Both sovereigns might well insist upon an exaction on the whole estate for the privilege of its transfer."

We are of the opinion that the decision of the United States Supreme Court in *New York Trust Company* v. *Eisner, supra*, is not controlling in the appeal at bar. Cf. *Appeal of Farmers Loan & Trust Co.*, 3 B. T A. [p. 3578 above].

Phillips concurring in the result, only.

U. S. BOARD OF TAX APPEALS.

Docket No. 3847.

Appeal of May S. Young, Executrix of the Estate of David G. Leggett, *Deceased.*

The New York transfer tax is deductible from the income of an estate in the year in which the tax is paid.

Submitted July 9, 1925. Decided Dec. 1, 1925.

Russell L. Bradford, Esq., for the taxpayer. E. C. Lake, Esq., for the Commissioner.

Before Marquette and Morris.

This appeal is from the determination of a deficiency in income tax for the period from April 27, 1923, to December 31, 1923, inclusive, in the amount of $222,958.15.

Two questions are raised, (1) whether the amount of $800,000 paid by the executrix to the State of New York as a transfer tax, is deductible from the income received by the executrix and (2) whether the amounts of rentals and bond interest which had accrued during the lifetime of the decedent, and were included within the gross estate of the decedent for Federal estate tax purposes, but were actually paid to the executrix, should be included within the income of the executrix.

Findings of Fact.

The taxpayer is the duly nominated and appointed executrix under the will of David G. Leggett, who at the date of his decease was a resident of New York.

Leggett died on April 27, 1923, leaving real and personal property within the State of New York having a gross value of $21,104,336.84, subject to deductions for New York transfer tax purposes of $1,056,567.66, or a net estate subject to New York transfer tax of $20,047,769.18. Leggett left real estate within the State of New York of a value of $2,710,400, which, by the ninth clause

of his will, he specifically devised to his nephew, David G. Leggett, and his niece, Mary S. Young. Leggett left no real estate within the State of New York which was not specifically devised as aforesaid.

The executrix, on or about October 24, 1923, paid to the State of New York, on account of transfer tax against the estate of Leggett, the sum of $800,000, which constituted a partial payment in advance.

By the fifth clause of his will, Leggett specifically bequeathed to J. deR. Whitehouse certain jewelry of the value of $750, and by the ninth clause of his will, he specifically bequeathed to David G. Leggett, the nephew, certain personal effects of a value of $28,046.55, the value of total specific bequests subject to tax being $28,796.55.

Leggett made no other specific bequests of personalty, except one to Vera Whitehouse of certain jewelry of the value of $500, which bequest was not subject to the New York transfer tax.

The executrix rendered a personal income tax return for the decedent covering the period from January 1, 1923, to April 27, 1923, and made a return as executrix for the period from April 27, 1923, to and including December 31, 1923. Both returns were made upon a cash receipts and disbursements basis.

In rendering her return as executrix, the taxpayer excluded from the report of total income the sum of $11,822.67, which represented rentals accrued to the date of the death of the decedent but not collected until after his death, which accrued rentals were included in the Federal estate tax return as capital. The executrix also excluded from the report of total income the amount of $33,609.80, which represented interest on bonds which had accrued to the date of the death of the decedent but were not collected until after the death, which accrued interest she also included as capital in the Federal estate tax return and in the New York transfer tax return.

The Commissioner included within the income re-

ported by the executrix for the period from April 27, 1923, to December 31, 1923, said amounts of $11,822.67 and $33,609.80, disallowed the deduction of the $800,000 paid to the State of New York as the transfer tax, and determined the net income of the executrix to be $639,-627.22, with a resulting deficiency in tax of $222,958.15.

DECISION.

The deficiency determined by the Commissioner is disallowed.

OPINION.

MARQUETTE: That the New York transfer tax, paid during 1923, is deductible from the gross income of the estate for that period was decided in *Appeal of Farmers Loan & Trust Co.*, 3 B. T. A. [p. 3578, above]; *Appeal of Edgar Munson*, 3 B. T. A. [p. 3643, above], and *Appeal of Joanna Lovett*, 3 B. T. A. [p. 3654, above]. Upon the authority of those decisions, the deficiency must be disallowed.

Since the deduction of $800,000 exceeds the entire net income of the estate for the period in 1923, it is unnecessary for us to decide the other questions presented for our consideration.

U. S. BOARD OF TAX APPEALS.

Docket No. 2940.

Appeal of Joanna Lovett, Executrix of the Estate of Thomas J. Lovett, *Deceased.*

During 1923 taxpayer estate paid a New York State transfer tax of $5,650.29 and claimed that amount as a deduction in its Federal income tax returns for that year. The deduction was allowed upon the authority of *Appeals of Farmers Loan & Trust Co.* and *Edgar Munson* [p. 3578 and 3643, *supra.*]—[Ed.].

Submitted July 1, 1925. Decided Dec. 1, 1925.

B. G. Simpich, Esq., for the Commissioner.

Before James, Littleton, Smith and Trussell.

This is an appeal from the determination of a deficiency in income tax for the year 1923 in the amount of $288.19. The sole issue is whether the New York State transfer tax is deductible by an estate in determining taxable net income.

Findings of Fact.

Thomas J. Lovett died a resident of the City of Buffalo, N. Y., prior to the year 1923, and Joanna Lovett was duly appointed executrix of his estate. During the year 1923 the executrix filed a New York State transfer tax return upon which was assessed a transfer tax of $5,650.29, which tax was paid by her in the year 1923. In making the income tax return for the estate for that year, the executrix deducted, as tax paid by the estate, the said amount of $5,650.29, and the Commissioner in the audit of the said return disallowed the said deduction and assessed the deficiency here in issue.

Decision.

The deficiency determined by the Commissioner is disallowed. *Appeal of Farmers Loan & Trust Co.,* 3 B. T. A. [p. 3578, above]; *Appeal of Edgar Munson,* 3 B. T. A. [p. 3643, above].

IN THE

Supreme Court of the United States

October Term, 1925.

No. 295

HENRY P. KEITH, Late Collector of United States Internal Revenue, for the First Collection District of New York,
Petitioner,

vs.

EMMA B. JOHNSON, Administratrix of the goods, chattels and credits which were of John G. Johnson, Deceased,
Respondent.

ON CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Brief of C. Alexander Capron, Russell L. Bradford, Walter F. Taylor and John M. Perry, as *Amici Curiae*.

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INDEX

AUTHORITIES CITED.

IN THE

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OCTOBER TERM, 1925.

No. 295

HENRY P. KEITH, Late Collector of United States Internal Revenue, for the First Collection District of New York, Petitioner, *vs.* EMMA B. JOHNSON, Administratrix of the goods, chattels and credits which were of JOHN G. JOHNSON, Deceased, Respondent.	

BRIEF OF AMICI CURIAE

Through the courtesy of counsel in the above entitled cause, and by the indulgence of this Court, permission to file this brief as *amici curiae* has been given to C. Alexander Capron, Russell L. Bradford, Walter F. Taylor and John M. Perry, who appear as counsel in pending causes which will be directly affected by the decision of this Court in this cause.

Statement

This action was brought in the United States District Court for the Eastern District of New York to recover income taxes paid by the Administratrix of the goods, chattels and credits, which were of John G. Johnson, deceased, upon the income of the estate for the period beginning March 24, 1917, the date of death, and ending December 31, 1917, under the provisions of the Revenue Act of 1916, as amended by the Revenue Act of 1917. By stipulation of the parties (R. Page 17) the only question presented for the decision of the Court was whether the transfer tax paid to the State of New York is such tax as should properly have been allowed as a deduction in computing the net income for the period for which the return was filed.

Judgment in favor of the defendant was entered by the District Court on the 26th day of September 1923 (Record, Page 9). It was affirmed by the Circuit Court of Appeals for the Second Circuit on the 28th day of November 1924, (Record, Page 20). The cause comes before this Court on Certiorari to the United States Circuit Court of Appeals for the Second Circuit, (Record, Page 21), 267 U. S. 590.

The Issue

The sole question for decision is: Was the New York Transfer Tax paid by the Administratrix in the period for which the return was filed, an allowable deduction in ascertaining the net income of the estate subject to the Federal Income Tax for that period?

ARGUMENT.

Introduction.

The Income Tax Act of 1913 contained no express provision taxing the income of estates or trusts. The Treasury Department maintained, however, that the income of estates or trusts was nevertheless taxable against the executor or trustee and attempted to collect taxes thereon. Its right to do so was contested and was denied by this Court in *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602. Accordingly, in the Revenue Act of 1916, Congress inserted a provision making the income of estates and certain trusts taxable and requiring that the tax be paid by the executor or the trustee (Sec. 216). The validity of this provision was upheld in *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509.

Congress might, we suppose, have provided that the income of estates and certain trusts should be taxed to the person who received the benefit, but it adopted the more simple method of declaring the estate or trust to be a tax entity and taxing it upon the income which it received, regardless of the fact that some beneficiary was the ultimate, although not the immediate, recipient of the bounty.

Section 5 (a) (3) of the Revenue Act of 1916 as amended by Section 1201 of the Revenue Act of 1917, provided that in computing net income subject to the Federal Income Tax there shall be allowed as a deduction:

> "Taxes paid within the year imposed by the authority of the United States, (except income and excess profits taxes), or its Territories, or possessions, or any foreign country, *or by the authority of any state*, county, school district, municipality, or other taxing subdivision of any state, *not including those assessed against local benefits.*" (italics ours)

The Government concedes that the New York Transfer Tax is a deductible tax under the provisions of the Act quoted above. The issue is raised as to who may make the deduction, the Administratrix who was required by statute to file the return for the Federal Income and the New York Transfer Taxes, against whom both taxes were assessed, who was personally liable for and who paid both taxes, or the beneficiaries of the estate.

In approaching the question, it is important to bear in mind that the duties of the Administratrix were to collect the assets, convert them into cash, pay the decedent's debts, pay the Federal Estate Tax and the New York Transfer Tax, make a return to the United States and to the State of New York of the income collected during the settlement of the estate, and pay the tax thereon,—then distribute the remaining cash to the next of kin. Further, it is important that the provisions of the New York Transfer Tax Law made the Administratrix personally liable for the payment of the tax (Sec. 224), provided that she should not be entitled to a discharge until the tax was paid (Sec. 236), expressly directed that from any distribution in cash she should deduct and pay to the State Tax Commission the amount of the tax, and in case of a distribution in kind authorized her to sell sufficient of the property to pay the tax (Sec. 224). It is true that the statute makes the tax a lien upon the property transferred and makes the beneficiary liable for it if he receives property upon the transfer of which the tax has not been paid. It is submitted, however, that the tax primarily was imposed upon and was payable by the Administratrix as the representative of the estate in process of settlement. If that be so, there can be no basis for the Government's contention,—for the most that is required as a condition to the deduction is that the tax was "imposed upon" and "paid by" the entity which must pay the Federal Income Tax.

POINT I.

THIS COURT DENIED AN APPLICATION FOR A WRIT OF CERTIORARI TO REVIEW A DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS, 2nd CIRCUIT, WHICH HELD THAT THE NEW YORK TRANSFER TAX IS NOT DEDUCTIBLE BY THE BENEFICIARIES.

Since the passage of the first Income Tax Law, various aspects of the general question here presented have been under consideration in the Federal Internal Revenue Department and in the Courts. The question was first presented in the Courts in the case of *Prentiss* v. *Eisner*, 260 Fed. Rep. 589, where a legatee under a will sued to recover Federal Income Taxes resulting from the disallowances of a deduction taken in her return for a portion of the New York Transfer Tax, which had been paid by the Executors of the Will under which she received her legacy.

The Circuit Court of Appeals on reviewing and affirming the decision of the District Court, 267 Fed. Rep. 16, held that the New York Transfer Tax Act, under which the tax is a lien on the estate payable by the Executor or Administrator, is a tax on the right to transmit property in general, not a tax payable by the legatee and, therefore, no deduction for the payment of such tax could be made in the income tax return of the legatee.

Application for a Writ of Certiorari to review this decision was made to this Court and denied (254 U. S. 647).

So that we may take it this Court has held, if in the administration of the estate which is the subject of the present appeal, the beneficiaries of the estate had in their income tax returns sought to take advantage of a deduction of any part of the amount paid to the State of New

York for Transfer Tax, such action on their part would be contrary to the decision of this Court. In the course of its opinion in *Prentiss* v. *Eisner*, the Circuit Court of Appeals said on page 21:

> "Now a succession tax is a tax upon a transfer of property in general, and as such is distinguishable from a legacy duty, which is a tax upon a specific bequest. Under the New York law the succession tax creates a lien upon the estate of the decedent at the moment of his death. The right of the state to the amount of this lien attaches at that time, and it must be paid before the transferee, legatee, or devisee ever gets anything, and the executor or administrator is personally liable for the tax until it has been paid. * * * *
>
> The fact, however, remains that if a legacy left by a will is \$10,000, and the executor has paid to the state on its account a tax of \$500, and then has turned over to the legatee \$9,500, the legatee has received, not \$10,000, but \$9,500, and the legatee has been enriched only to the extent of the amount which he has himself received, and he has not paid the tax, nor has it been paid by his authority, nor by any one representing him. The payment has been made by the personal representative of the deceased, and in making it he has acted under authority of the statute."

The Government here contends that the New York Transfer Tax is deductible by the beneficiaries of the estate. No explanation is made why it is not foreclosed from doing so by the decision in this case.

In each of the following cases a similar contention has been overruled.

Prentiss v. *Eisner* (supra).

Keith v. *Johnson*, 294 Fed. 964 (D. C. E. D., N. Y.).

Keith v. *Johnson*, 3 Fed. (2nd) 361 (C. C. A. 2d Cir.).

Farmers Loan & Trust Co. v. *United States. Corporation Trust Company Income Tax Service*, 1925 p. 1082 (D. C., S. D., N. Y.).

Appeal of *Farmers Loan & Trust Co.*
3 Commerce Clearing House, U. S. Board of Tax Appeals Service, p. 3578.

Appeal of *Munson*,
3 Commerce Clearing House, U. S. Board of Tax Appeals Service, p. 3643.

Appeal of *Young*,
3 Commerce Clearing House, U. S. Board of Tax Appeals Service, p. 3650.

POINT II.

THE NEW YORK TRANSFER TAX PAID BY THE ADMINISTRATRIX IN THE PERIOD FOR WHICH THE RETURN WAS FILED IS AN ALLOWABLE DEDUCTION IN ASCERTAINING THE NET INCOME OF THE ESTATE FOR THAT PERIOD REPORTED FOR PURPOSES OF FEDERAL INCOME TAX, UNDER THE DECISION OF THIS COURT IN *UNITED STATES* v. *WOODWARD*, AND THE DECISION OF THE COURT OF APPEALS OF NEW YORK IN *PEOPLE EX REL. HOME TRUST CO.* v. *LAW*.

In *United States* v. *Woodward*, 256 U. S. 632, this Court decided that the Federal Estate Tax paid by the Executors in that case and claimed by them as a deduction in their income tax return for the year 1918 was an allowable deduction in ascertaining the net taxable income of that estate for that year.

It is the contention of the respondent that the intrinsic nature and purpose of the New York Transfer

Tax is the same as that of the Federal Estate Tax and that, therefore, the reasoning of this Court in the Woodward case applies to the question presented by the record in this case and sustains the contention of the respondent.

In the *Woodward case* this Court said, on page 633:

> "The sole question for decision is, was the estate tax paid by the executors and claimed by them as a deduction in the income tax return for the year 1918, an allowable deduction in ascertaining the net taxable income of the estate for that year? * * *
>
> "The solution of the question turns entirely upon the statutory provisions under which the two taxes were severally collected. The Act of 1918, by Sections 210, 211 and 219 subject the net income 'received by estates of deceased persons during the period of administration or settlement', to an income tax. . . . Section 214 makes express provision for the deduction of 'taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war profits and excess profits taxes'. This last provision is the important one here. It is not ambiguous but explicit, and leaves little room for construction. The words of its major clause are comprehensive and include every tax which is charged against the estate by the authority of the United States. The excepting clause specifically enumerates what is to be excepted. The implication from the latter is that the taxes which it enumerates would be within the major clause were they not expressly excepted, and also that there was no purpose to except any others. Estate taxes were as well known at the time the provision was framed as the ones particularly excepted. Indeed, the same act, by Sections 400-410, expressly provides for their continued imposition and enforcement. Thus their omission from the excepting clause means that Congress did not intend to except them."

Section 1201 of the Act of 1917 (which, so far as consideration of the question here presented is concerned, is identical with Section 214 of the Act of 1918 referred to in the *Woodward* decision) makes express provision for the deduction of "taxes paid within the year imposed by the authority of the United States (except income and excess profit taxes) or of its territories or possessions, or of any foreign country or *by the authority of any state, county, school district, or municipality or other taxing subdivisions of any state, not including those assessed against local benefits.*"

What was said of Section 214, in the foregoing quotation from the opinion in the *Woodward* case, is equally applicable to Section 1201 as to Transfer and Inheritance Taxes of the various states, which were, at the time of the passage of the Act, well known; the statute in New York, for instance, having been in existence since about the year 1885.

In view of the decision in the *Woodward* case, and of the wording of the statute under consideration, permitting the same deductibility of taxes which are imposed by the authority of any state that is permitted when taxes are imposed by the authority of the United States, is there any legal distinction between the question presented by the case at bar and the question decided in the *Woodward* case?

The New York Courts following the decision in the *Woodward* case have permitted Executors, in determining the amount of income subject to the tax imposed by the New York Income Tax Act, which in all material respects, is identical with the Federal Income Tax Act, to deduct the Transfer Tax imposed by the New York law, on the ground that the intrinsic nature and purpose of the Federal Estate Tax and the New York Transfer Tax are the same.

It was so decided in the *Matter of Application of Home Trust Company as Executor of Andrew Carnegie*

v. *Law*, 204 A. D. 590, affirmed by the Court of Appeals in 236 N. Y. 607. There was no opinion written in this case by the Court of Appeals, but the opinion of the lower Court, accompanied its judgment which was affirmed by the Court of Appeals. In that opinion in referring to the State Income Tax it was said at page 591:

> "The tax thus laid is patterned after the Federal tax imposed upon the net income of individuals. (Revenue Act of 1918, Section 210). That tax was made applicable to estates of deceased persons and is imposed upon the net income of such estates during the process of administration or settlement. (Revenue Act of 1918, Section 219.) Moreover the tax deductions authorized to be made in calculating annual net income are substantially the same under both the Federal and State Law. . . . If, therefore, the tax imposed by Section 220 of the Tax Law upon 'taxable transfers' and the Federal 'estate tax' are taxes of an identical or similar nature, we have in the case of *United States* v. *Woodward* (supra), a very definite precedent for drawing the conclusion that a transfer tax, paid by an executor under the laws of this state during a given year, is deductible from the gross income of the estate for the year, in order to determine the State Income Tax due from the estate in that year. . . .
>
> There are variances between the two laws" (I. E. Federal Estate Tax Law and the New York State Tax Law) "in respect to the rates charged, the exemptions permitted, the deductions authorized, as well as in other particulars. *However, the intrinsic nature and purpose of the tax is the same in either case.* Therefore, it seems to me that since the one tax is deductible from gross revenue to determine the taxable net income of an estate under the Federal law, the other tax should be held to be deductible to determine the taxable net income of an estate under the State law. . . .
>
> "Aside from authority and theory we think it was the clear legislative intent, as indicated by the various provisions of the Tax law" (STATE TAX

LAW) "that in calculating the net income of the estate of a decedent for income tax purposes, the amount paid by an executor during the year in satisfaction of a Transfer Tax should be deducted. *The income tax payment is made by the executor of the estate from funds of the estate and not from funds belonging to legatees.* (*Kings County Trust Company* v. *Law*, 201 App. Div. 181). *The transfer tax payment is made by the executor from the funds of the estate.* 'The transfer tax is imposed upon the estate of the decedent as it exists at the hour of his death, and its value is to be fixed as of that time.' * * * *Thus the tax is measurable not by the funds received by a legatee, but by the funds the executor receives.* As the burden of paying the income tax, as well as the burden of paying the transfer tax is cast upon the executor, and as the taxable income of the estate is under the terms of the Tax law measurable by gross income received less taxes paid, it would seem clear that the person paying the income tax, namely, the executor, is entitled to deduct the very transfer tax which he himself pays." (Italics supplied.)

In view of this decision of the Court of the State of New York construing the New York State Transfer Tax as identical in nature and purpose with the Federal Estate Tax and in view of the fact that the Federal statute grants equal deductibility to Federal and State Taxes, and in view of the fact that the Supreme Court has held, in the circumstances, the Federal Tax is deductible, it is submitted that there is no sound legal ground for the contention that the State Transfer Tax is not also deductible.

This Court had no difficulty in reaching the conclusion that the Federal Estate Tax, which constitutes a lien upon the property and is a liability against the beneficiary as well as against the executor, was a tax imposed upon the estate, although, of course, the ultimate burden falls upon the beneficiaries, or some of

them. This Court did not interest itself in the niceties of the situation and did not concern itself with technicalities. It perceived that Congress had expressly provided that an estate should be deeemd a taxable entity and that the executor should pay a tax upon the income received by the estate regardless of its ultimate destination, and that Congress had also provided that taxable entities, estates as well as individuals, should be allowed to deduct all taxes paid by them other than income taxes, excess profits taxes, and taxes assessed for local benefits. It concluded that a tax imposed on account of the transfer of property from the decedent to the beneficiary and payable by the executor out of the funds in his hands necessarily came within the deductions contemplated by Congress.

Undoubtedly, the reason that in the *Woodward* case the language of this Court is not more apposite upon the point that the tax is deductible by the estate as distinguished from the beneficiary, is that the Government did not suggest that there was any such alternative and did not attempt to say that the deduction should be allowed to the beneficiary and not to the estate. The argument of the Government was that the Federal Estate Tax was not a tax at all, but was in the nature of an escheat to the United States.

In the *Home Trust Company* case the New York Court of Appeals, in construing the New York Income Tax, which, it is we think admitted, was a copy of the original Federal statute and was in all material respects identical with the Federal statute involved in the case at bar, held that under the provision permitting the deduction of taxes, the New York Transfer Tax, being a tax payable on account of the right of a decedent to transmit his property, and being payable by the executor out of funds in his hands, was deductible by the estate. The New York Court in that case, like this Court in the *Woodward* case, indulged in no consideration of technicalities and fine-spun distinctions which could not have

been in the mind of the Legislature when it provided for the deduction of taxes. The underlying thought which prompted the decision is expressed in the single sentence:

> "As the burden of paying the income tax, as well as the burden of paying the transfer tax is cast upon the executor, and as the taxable income of the estate is under the terms of the Tax Law measurable by gross income received less taxes paid, it would seem clear that the person paying the income tax, namely, the executor, is entitled to deduct the very transfer tax which he himself paid."

The decision of the Circuit Court of Appeals in the case at bar was based on the same fundamental point. Thus, Judge Learned Hand, after calling attention to the provisions of sections 2 and 5 of the Revenue Act of 1916, said (3 Fed. 2nd. 361):

> "As section 2 (b) assesses the tax against the executor personally, he is the 'citizen or resident' of section 5 who may deduct the state tax. The case at bar therefore turns on whether the New York inheritance tax is 'imposed' on him. At least, if it is so imposed, section 5 covers him. That is a question of New York law, and we are bound by the decisions of the New York Court of Appeals on that question.
>
> The New York inheritance tax is imposed by section 220 of the Tax Law (Consol. Laws N. Y. c. 60) on 'the transfer of property.' This is ambiguous in respect of its incidents, but section 224 enacts that the tax shall be 'a lien upon the property transferred . . . and the executors . . . of every estate so transferred shall be personally liable for such tax until its payment.' We think that in principle under this provision the tax is 'imposed' on the executor, and that it was so ruled in *Home Trust Co. v. Law*, 204 App. Div. 590, 198 N. Y. S. 710, affirmed in 236 N. Y. 607, 142 N. E. 303."

The only conceivable reason why the New York Transfer Tax might be deductible by the beneficiaries rather than by the estate is that the ultimate burden of the tax falls upon the beneficiaries. But this is not a good reason for such a conclusion. In the first place, the same thing is true of the Federal Estate Tax, for, obviously, the persons who are ultimately out of pocket are the residuary beneficiaries, and it has been held that this is no reason for denying the deduction to the estate. In the second place, the suggestion confuses the incidence of the tax with the impact of the tax. The question is not "Who bears the ultimate burden?" but "Upon whom is the tax imposed?" The distinction is one well known to the economists. Professor Seligman has written a book on the "Incidence of Taxation", on page 2 of which he says:

> "The impact of a tax is therefore the immediate result of the imposition of a tax on the person who pays it in the first instance. . . . We thus have the three distinct conceptions—the impact, the shifting, and the incidence of a tax, which correspond respectively to the imposition, the transfer, and the settling, or coming to rest, of the tax. The impact is the initial phenomenon, the shifting is the intermediate process, the incidence is the result. To confuse the impact with the incidence is as reprehensible as to confound the incidence with the shifting."

If the incidence of a tax is to be the test of deductibility, every taxpayer will require the advice of an economist in making up his income tax return.

In the third place, the Congressional intent that the estate shall pay a tax upon the income received by it and that it may deduct taxes paid by it are reciprocal. In making the estate pay a tax upon the income, Congress was not bothered by the fact that the estate did not get the ultimate benefit of the income so received, but that

the true beneficial recipients were the beneficiaries. By the same token it is to be presumed that it was no part of its intent that the right to deduct taxes paid by the estate should depend upon the question of who ultimately bears the burden, so long as the tax is imposed upon the estate.

Finally, it is to be noticed that to say that the New York Transfer Tax is deductible by the beneficiaries and not by the estate would lead to utterly illogical results. So long as the transfer tax is deductible only by the estate, it is substantially deductible only from the income from the property on account of the transfer of which the tax is paid. But if the transfer tax is deductible by the beneficiaries, it will serve as an offset against income derived not only from the property transferred, but from other sources.

From the point of view of the income tax, the legatee, as such, has no relation to the decedent's estate. The legacy he receives is not subject to the income tax.

The income which the estate receives is by the express terms of the statute made subject to the income tax.

It it reasonable to suppose that when Congress permitted the deduction of "taxes" from gross income to ascertain the net income which was subject to income tax, it contemplated the entity which received the income and was liable for its payment, rather than one who was in no wise liable for income tax on that which he received.

There are, of course, differences between the Federal Estate Tax and the New York Transfer Tax. They are pointed out in the opinion of the Court in the *Home Trust Company* case (204 N. Y. App. Div. 590) and found to be insufficient to furnish the basis for a distinction as to deductibility. We shall not examine the differences in detail, for there is no basis for the assumption that such differences in detail were thought by Congress to require a different rule of deductibility.

To summarize: The New York Legislature imposed a tax upon the transfer of the property of a decedent and thereunder, as was said in the *Home Trust Company* case, "the burden of paying the transfer tax is cast upon the executor" and the "payment is made by the executor from the funds of the estate." Congress enacted that the estate of a decedent should constitute a taxable entity and that the executor should pay an income tax upon the income received by the estate. Congress further provided that a taxpayer might deduct from gross income taxes paid within the year imposed by the United States or a State. This Court held in the *Woodward* case that Congress thereby expressed an intention that the Federal Estate Tax should be deducted from the gross income of an estate. The New York Court of Appeals held in the *Home Trust Company* case that the New York Transfer Tax and the Federal Estate Tax "are taxes of an identical or similar nature" and that "the intrinsic nature and purpose of the tax is the same in either case." The Circuit Court of Appeals for the Second Circuit held that the New York Transfer Tax might *not* be deducted from the gross income of the *beneficiary* of an estate,—and this Court refused to review the decision. It is admitted that the New York Transfer Tax is deductible either by the estate or by the beneficiaries of the estate. Why should the Treasury Department attempt to deny the deduction to the estate which is the respondent here?

POINT III.

THERE IS NO MERIT IN THE GOVERNMENT'S ARGUMENT THAT THE QUESTION NOW PRESENTED HAS ALREADY BEEN DECIDED IN ITS FAVOR BY THIS COURT.

The Government now throws aside all the theories previously advanced and for the first time it stands flatly upon the proposition that this Court has already decided the question in *New York Trust Company* v. *Eisner* —a case in which the question was not and could not have been presented.

The Government, as we have said, admits that the New York Transfer Tax is deductible either by the estate or by the beneficiaries. It advances only a single argument why it is not deductible by the estate. That argument is based upon three propositions:

(1) In the *Woodward* case this Court held that there may be deducted by an estate for purposes of the Federal Income Tax only such taxes as are "charges against the estate" and "are paid by the personal representative substantially as other taxes are paid."

(2) In the *New York Trust Company* case, this Court held that the New York Transfer Tax is not a "charge against the estate".

(3) The New York Transfer Tax is not "paid by the personal representative substantially as other taxes are paid" because it is paid out of the particular shares after those shares have been determined.

Unless the Government can sustain the first proposition and either the second or the third proposition, it virtually concedes the soundness of our case. We shall examine the correctness of each of these propositions separately.

(1) *This Court did not decide in the Woodward case that there may be deducted* **only** *such taxes as are "charges against the estate" and "are paid by the personal representative substantially as other taxes are paid."*

The *Woodward* case, it will be remembered, involved the question of the right of an estate to deduct the Federal Estate Tax for purposes of the Federal Income Tax. The argument of the Government was not, as here, that no deduction should be allowed to the estate because under the statute it is allowed to the beneficiary, but on the contrary, that the Federal Estate Tax was not deductible by any one because it was not a tax at all within the meaning of the statute. The Government's theory was that immediately upon the death the proportion of the estate fixed by the statute was instantly set aside in trust for the United States, and that upon the expiration of the year at the end of which the statute required the payment, the United States became entitled to the property so set aside as an escheat, and when the executor paid the Collector of Internal Revenue he was merely transferring to the United States the property which had escheated to it under the statute. It was in answer to this argument that this Court used the language upon which the Government now relies. In indicating why it considered that the payment required by the statute was a tax, it said that the payment was a charge against the estate, thereby differentiating it from an escheat. It said that the payment is made "by the personal representative substantially as other taxes are paid" without detailed analysis of the fund from which it was required to be paid or inquiry as to the ultimate burden of the payment, and it intended to express thereby its opinion that so far as the method of payment prescribed by the statute was concerned, there was, in a broad sense, no reason to

differentiate it from other taxes payable by individuals, estates or trusts.

The Government seizes upon those words as used to point out a particular and fundamental distinction between the payment required by the statute as the court conceived of it, and the payment required by the statute as the Government attempted to represent it, in a case in which it held that the payment was a proper deduction, and it attempts to construe them into a limitation— a pronouncement that only such taxes as are "charges against the estate" and as "are paid by the personal representative substantially as other taxes are paid" may be deducted. We think we are right in saying that nothing was further from the mind of this Court.

The vice in the Government's argument lies in saying that the words there used are to be given the same meaning as somewhat similar words used by this Court in the *New York Trust Company* case in connection with an entirely different question.

(2) *The language used in the opinion in the New York Trust Company case that the New York Transfer Tax is not a "charge against the estate" within the meaning of the Federal Estate Tax and that for purposes of the Federal Estate Tax it is only charges against the estate as a whole which may be deducted, have no bearing upon the present question; namely, whether the New York Transfer Tax is a tax imposed upon the estate so as to be deductible under the Federal Income Tax, by the estate rather than by the beneficiaries.*

The New York Trust Company v. *Eisner*, 256 U. S. 345, involved, first, the question of the constitutionality of the Federal Estate Tax and, second, the question of whether the New York Transfer Tax was deductible in determining the value of the net estate subject to the Federal Estate Tax under the provision permitting the

deduction of funeral expenses, administration expenses, claims against the estate, mortgages, losses and "such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered." It was held that the Federal Estate Tax was constitutional and that the statute did not permit the deduction of the New York Transfer Tax.

So far as the decision itself is concerned, it could scarcely be argued that it forecloses the question whether the New York Transfer Tax is such a tax as may be deducted by an estate under the provision of the Federal Income Tax permitting the deduction of taxes imposed upon the estate. On the constitutional point the taxpayer had argued that the Federal Estate Tax infringed upon the rights of the States to regulate the transmission of property from the dead to the living, because it attached at the moment of death and instantly took out of the estate sufficient property to pay the tax. But on the point of the deductibility of the New York Transfer Tax, the taxpayer argued that the New York Transfer Tax should come first and be deducted from the net estate upon which the Federal tax was to be computed. In answering this argument, this Court said (256 U. S. 349):

> "There remains only the construction of the act. The argument against its constitutionality is based upon a premise that is unfavorable to the contention of the plaintiffs in error upon this point. For if the tax attaches to the estate before distribution—if it is a tax on the right to transmit, or on the transmission at its beginning, obviously it attaches to the whole estate except so far as the statute sets a limit. 'Charges against the estate' as pointed out by the Court below are only charges that affect the estate as a whole, and therefore do not include taxes on the right of individual beneficiaries. This reasoning excludes not only

> the New York succession tax but those paid to other States, which can stand no better than that paid in New York. What amount New York may take as the basis of taxation and questions of priority between the United States and the State are not open in this case."

Obviously in meeting this argument on the construction of a statute which did not include "taxes" as a deduction the Court was not considering the question now presented, and this is emphasized by the fact that within a month after the decision of the New York Trust Company case this Court by unanimous decision decided the *Woodward* case where the definition of "taxes" was essential and where the result was that to which we have already alluded.

The truth of the matter is that the argument which the Government is now making never could have been made if the opinion in the *Woodward* case had not, in holding the Federal Estate Tax deductible, referred to it as a "charge against the estate." The argument is nothing but a play on words. When words are used in totally different connections, they are very apt to have totally different meanings. Mr. Justice Holmes, in *Towne* v. *Eisner*, 245 U. S. 418, expressed the thought in a sentence which will become a classic:

> "But it is not necessarily true that income means the same thing in the Constitution and the act. A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used."

(3) *The fact that the amount of the individual shares of each beneficiary is determined without first deducting from the entire estate the amount of the New York Transfer Tax has nothing to do with the question of deductibility by the estate.*

The third proposition in the Government's argument, whereby it seeks to prove that the decisions of this Court shall be that the New York transfer tax is not deductible for purposes of the Federal income tax, is that the transfer tax is not paid "substantially as other taxes are paid" and that therefore it does not come within the limitation which the Government says was laid down in the *Woodward* case. The reason which the Government gives in support of the statement that the New York Transfer Tax is not paid "substantially as other taxes are paid" is that "it is paid out of the particular shares after these shares have been determined". The same thought is expressed in the Government's brief as follows:

> "The intention is that the tax *must reduce* the assets of the estate available for distribution, and that so long as the estate is entitled to reimbursement, as it is under the New York law, it is not, in theory or in practice, reduced by the payment."
>
> * * * * * * *
>
> "But it is incongruous to say that a tax is imposed upon an estate before distribution when the estate before distribution is not reduced by the payment of the tax."

What the Government means is explained in the examples given in Appendix C of its brief. Its meaning is that the executor, instead of first determining the amount of the tax to be paid and deducting that from all of the assets in his hands and then allocating those assets in accordance with the will or the statute of distributions, first determines the distribution of the assets as if there

were no transfer tax to pay. But this, of course, has no significance except to show that the method of determining the amount of the New York tax is to first determine the amount which each beneficiary gets rather than the total amount distributable among all the beneficiaries. This distinction is immaterial upon the question whether the tax is imposed upon the estate. In either event, it must be paid out of the assets in the hands of the executor. The controlling factor in determining whether the tax is imposed upon the estate within the intent of Congress, is whether it is required to be paid by the executor out of some funds coming into his hands, and the Government does not attempt to deny that this is the fact.

These things were material in the *New York Trust Company* case because the question there was whether the New York Transfer Tax was a liability existing before the moment of the impact of the Federal Estate Tax, and they went to prove that that was not the case. The argument of the Government, therefore, only tends to prove that the New York Transfer Tax is not deductible for purposes of determining the net estate subject to the Federal Estate Tax, which is a totally different question from the question involved in the case at bar, namely, whether the tax is one imposed upon the estate so as to come within the class of taxes which Congress permitted to be deducted by the estate in determining its taxable net income.

We shall not refer to the New York or United States Supreme Court cases cited on pages 14 to 18 of the Government's brief, further than to say that in none of them was there any issue as to the question which is in issue in the case at bar, and that even if some of the language of the court may conceivably seem to be inconsistent with our conception of the nature of the New York Transfer Tax, it must be borne in mind that the language was used loosely and without reference to the point which is in

issue here. (See *Appeal of Farmers Loan & Trust Co.*, 3 Commerce Clearing House, U. S. Board of Tax Appeals Service, p. 3578.) In only one New York case, and in only one United States Supreme Court case, has that point been material. The New York case is the *Home Trust Company* case, where it was held that the New York Transfer Tax is precisely the same in effect, for purposes of what is substantially the issue here, as the Federal Estate Tax. The United States Supreme Court case is *Prentiss* v. *Eisner* where the Circuit Court of Appeals held, and this Court refused to reconsider, that the nature of the New York Transfer Tax is such that under the Federal Income Tax it is not deductible from the income of the beneficiaries of an estate, thereby rendering it necessary to accept the alternative that it is deductible by the estate.

It may be well to mention that there are two minor details upon the basis of which the Government attempts to draw a distinction between the Federal Estate Tax and the New York Transfer Tax for purposes of the present question.

The first is that, if a gift to a beneficiary is not in money, the "executor is required to collect the tax thereon from the person entitled thereto and he cannot be compelled to deliver the property until the beneficiary has paid the tax thereon." This provision is contained in section 224. The purpose of this provision is apparently to render possible what otherwise would not have been possible, namely, the delivery to the beneficiary of the specific property distributable to him. Without such a provision, it would, under the other provisions of the statute, have been necessary for the executor to sell the property, which might be an heirloom or a painting, and thus deprive the beneficiary of the very thing which the decedent wished him to have or that the beneficiary desired. The other provision referred to by the Government is that permitting a refund to the beneficiary,

if debts discovered after the distribution require the repayment by the beneficiary of part of the property distributed to him. This is contained in section 225 and it will be noticed that the refund is made to the executor, unless the tax has actually been advanced by the beneficiary, which is of course a rare case.

At the very end of the Government's brief, the argument is made that, so far as the New York Transfer Tax is imposed on real estate, it ought not to be deductible by the estate because the real estate vested immediately in the beneficiaries and never became a part of the estate in the hands of the executor. It is then argued that since it would be very difficult to separate the tax on real estate from the tax on personalty, no part of the tax should be deducted. However, we do not admit that there is any difference between the tax upon real estate or specifically bequeathed property and the tax upon the administration of personal property. In each case in which the question has been presented either the Court or the Board of Tax Appeals has held that the tax is of the same character and that it is deductible from the income of the estate. But, assuming that such a distinction can be made—which we do not admit—the basis for that distinction is not present in the case in suit. (See cases cited on pages 6 and 7.)

The whole argument of the Government proceeds upon the misconception that the New York Transfer Tax may not be deducted for purposes of the Federal Income Tax, if it may not be deducted for purposes of the Federal Estate Tax.

POINT IV.

EVEN IF IT BE ERRONEOUSLY ASSUMED THAT IN THE *NEW YORK TRUST COMPANY* CASE THIS COURT REACHED THE CONCLUSION THAT THE NATURE OF THE NEW YORK TRANSFER TAX IS SUCH THAT IT IS NOT DEDUCTIBLE BY AN ESTATE FOR PURPOSES OF THE FEDERAL INCOME TAX, THIS CONCLUSION WILL BE RECONSIDERED IN THE LIGHT OF WHAT THE NEW YORK COURT OF APPEALS SUBSEQUENTLY DECIDED IN THE *HOME TRUST COMPANY* CASE.

We do not for one moment believe that this Court in the *New York Trust Co.* case reached or expressed any conclusion with respect to the nature of the New York Transfer Tax which is either controlling or persuasive in connection with the question before it in this case. It merely held that the Federal Estate Tax and the New York Transfer Tax were of equal dignity, and that both attached at the moment of death (as to New York Transfer Tax see *Matter of Hubbard,* 234 N. Y. 175, and see *New York Trust Co.* v. *Eisner* as to Federal Estate Tax, and that neither came before, or was deductible from, the other, see also *Stebbins* v. *Riley,* 268 U. S. 137, and *Frick* v. *Pennsylvania,* 45 S. Ct. 603. If, however, we are wrong, and such a conclusion was reached or expressed, there can be no doubt that the subsequent decision of the New York Court of Appeals construing the New York Transfer Tax furnishes a reason for the reconsideration of such a conclusion. It is true, of course, that the fundamental question in the present case is the construction of the provision in section 5(a) of the Revenue Act of 1916 permitting the deduction by a taxpayer of taxes paid within the year. In construing that provision, this Court is not

required to follow anything that a State court may have said. But, since the ultimate purpose sought in construing this provision is to determine whether the New York Transfer Tax is of such a nature that it comes within the intent which Congress expressed in that provision, the decision of the New York Court of Appeals in the first case involving the nature of the New York Transfer Tax for purposes of the general question here involved, will be accorded great weight, if it be not regarded as conclusive. It is clear on both principle and authority that, although a State statute may have been construed by this Court, it will change its construction to conform to that of the State Court announced in decisions subsequent to the first decision of this Court.

In *Fairfield* v. *County*, 100 U. S. 47, this Court said:

> "We recognize the importance of the rule *stare decisis*. We recognize also the other rule, that this court will follow the decisions of State courts, giving a construction to their constitutions and laws, and more especially when those decisions have become rules of property in the States, and when contracts must have been made, or purchases in reliance upon them. *And it has been held that this court will abandon its former decision construing a State statute, if the State courts have subsequently given to it a different construction.* In *Green* v. *Neal's Lessee* (6 Pet. 291), the question raised was whether the court would adhere to its own decision in such a case, or would recede from it and follow the decisions of the State court. In two previous cases a certain construction had been given to a statute of Tennessee in supposed harmony with decisions of the State court. But subsequently it was decided otherwise by the State Supreme Court; and it appeared that the decisions upon which this court had relied were made under peculiar circumstances, and were never in the State considered as fully settling the construction of the act. *This court, therefore, overruled its former two decisions, and followed the later con-*

struction adopted by the State court. See also *Suydam* v. *Williamson*, 24 How. 427."

In *Green* v. *Neal's Lessee*, mentioned in the foregoing quotation, this court said (at p. 298):

> "It is admitted in the argument, that this court, in giving a construction to a local law, will be influenced by the decisions of the local tribunals; but, it is contended, that when such a construction shall be given in conformity to those decisions, it must be considered final. That if the State shall change the rule, it does not comport either with the consistency or dignity of this tribunal to adopt the change. . . .
>
> If the construction of the highest judicial tribunal of a State form a part of its statute law, as much as an enactment by the legislature, how can this court make a distinction between them? There could be no hesitation in so modifying our decisions as to conform to any legislative alteration in a statute; and why should not the same rule apply where the judicial branch of the state government, in the exercise of its acknowledged functions, should by construction, give a different effect to a statute, from what had at first been given to it. . . The inquiry is, what is the settled law of the State at the time the decision is made. This constitutes the rule of property within the State, by which the rights of litigant parties must be determined."

For decisions of Federal appellate courts, reversing decisions of lower Federal courts because of State decisions rendered while the case was on appeal, see *Metzger Company* v. *Parrott*, 233 U. S. 36; *Fleischman* v. *Burns*, 284 Fed. 358.

The Government cites *Carroll County* v. *Smith*, 111 U. S. 556, as laying down a contrary rule, but the following quotation from the opinion makes it clear that it does not do so, save under very peculiar facts, which do not exist in the case at bar (p. 562):

> "The decision in *Hawkins* v. *Carroll County*, above referred to, is not a judgment of the Supreme Court of Mississippi, construing the Constitution and laws of the State, which, without regard to our own opinion upon the question involved, we feel bound to adopt and apply in the present case. It is a decision upon the very bonds here in suit, pronounced after the controversy arose, and between other parties. It was not a rule previously established, so as to have become recognized as settled law, and which, of course, all parties to transactions afterwards entered into would be presumed to know and to conform to. When, therefore, it is presented for application by the courts of the United States, in a litigation growing out of the same facts, of which they have jurisdiction by reason of the citizenship of the parties, the plaintiff has a right, under the Constitution of the United States, to the independent judgment of those courts, to determine for themselves what is the law of the State, by which his rights are fixed and governed. It was to that very end that the Constitution granted to citizens of one State, suing in another, the choice of resorting to a federal tribunal. *Burgess* v. *Seligman*, 107 U. S. 20, 33."

The point is particularly pertinent if we assume the correctness of the Government's argument that this Court has construed section 5(a) of the Revenue Act of 1916 to permit the deduction by an estate only of such taxes as constitute "charges against the estate", for it can hardly be disputed that in the *Home Trust Company* case, the New York court construed the New York Transfer Tax to be a "charge against the estate" when it said that "the burden of paying the transfer tax is cast upon the executor" and the "payment is made by the executor from the funds of the estate."

CONCLUSION.

For the reasons stated, the judgment in favor of the defendant should be affirmed.

Respectfully submitted,

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